

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

In the Matter of the Application of SAN GABRIEL VALLEY WATER COMPANY (U337W) for Authority to Increase Rates Charged for Water Service in its Fontana Water Company Division to Increase Revenues by \$11,573,200 or 39.1% in 2003, \$3,078,400 or 7.3% in 2004, \$3,078,400 or 6.8% in 2005, and \$3,079,900 or 6.4% in 2006, and

A.02-11-044

In the Matter of the Application of San Gabriel Valley Water Company (U337W) for Authority to Increase Rates Charged for Water Service in its Fontana Water Company Division By \$5,662,900 or 13.1% in July 2006, \$3,072,500 or 6.3% in July 2007, and \$2,196,000 or 4.2% in July 2008.

A.05-08-021

OPENING BRIEF OF THE DIVISION OF RATEPAYER ADVOCATES

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PROPOSED FINDING OF FACT

PROPOSED CONCLUSIONS OF LAW

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I. SUMMARY

The Division of Ratepayer Advocates (“DRA”) finds San Gabriel Valley Water Company (“San Gabriel” or the “Company”) has not met its burden with “clear and convincing” evidence showing their proposed rate increases are “just and reasonable.” In numerous areas, through discovery, direct and reply testimony, and evidentiary hearings, San Gabriel’s showing is wholly inadequate. For example, San Gabriel has not met its burden to justify various capital projects, specifically the Sandhill Plant, new office building, wells, and reservoirs, certain operating and maintenance, and administrative and general expenses.

The Water Division’s Audit, which was ordered in San Gabriel’s previous rate case showed that San Gabriel violated Sections 790, 851, and D.03-09-021 with its misappropriation of over \$27 million. San Gabriel has also actively misled the Commission and violated Commission rules. As evidenced in the evidentiary hearings, it misrepresented its actual water supply, the Sandhill Project’s actual costs, and the need for various plant projects, and engaged in an illegal affiliate transaction.

DRA proposes setting a fine that will deter future violations not only of San Gabriel, but of other companies in the Water Industry. San Gabriel cannot be rewarded for actions that have thwarted and attempted to subvert the regulatory process. ALJ Barnett’ proposed split of the proceeds of 75% to ratepayers and 25% to shareholders would encourage such bad behavior because San Gabriel would be allowed to retain one-quarter of its ill-gotten gains. Therefore, 100% of the Audit proceeds should be assigned to ratepayers as CIAC. The final resulting required operating revenues for Test Year 2006-2007 would be \$37,473,300 when the impact of the Water Division audit recommendation, flowing back 100% of the proceeds to ratepayers, is incorporated.

The following are some areas where DRA and San Gabriel are in agreement. DRA agrees with San Gabriel’s estimates of number of customers. Also, DRA accepts San Gabriel’s methodology and estimates for each category of Other Revenues (Ex. 45,

pp. 2-5 – 2-6) and the amount proposed by San Gabriel for Miscellaneous Revenues in the forecasted Test Year 2006-2007, with the exception of one revision (Ex. 45, p. 2-6).

DRA agrees with San Gabriel's proposed 6.2% unaccounted for water factor, which is based on a 5-year average amount, is less than the amount included in the Company's prior rate case, and is reasonable as compared to other utilities. (Ex. 45, p. 2-4) and that San Gabriel's proposed \$4,659,500 or \$0.094782/kWh forecast for Test Year 2006-2007 is reasonable. DRA concurs with San Gabriel on the amount included in the filing for chemical costs for Plant F17. (Ex. 45 at 3-4)

Additionally, DRA concurs that San Gabriel's use of actual 2004 amounts, as escalated, for Utilities and Rents is reasonable. DRA agrees with San Gabriel's forecasts and methodology for projecting dental insurance expense, with the exception of the impact of DRA's adjustment for the number of employees. DRA accepts San Gabriel's projected umbrella insurance policy costs. (Ex. 45, pp. 4-1- 4-2)

DRA agrees with San Gabriel's allocated common costs amount of \$2,987,800 for Test Year 2006-2007. (Ex. 1 at 11-5) DRA does not object to the Company's budgeted \$2.1 million for its SCADA System in 2005 (Ex. 9, p.32/33) and San Gabriel's budgeted \$1.5 million for the cost of new security devices. Lastly, DRA does not object to the Company's assumption and calculations regarding its California Alternative Rates for Water ("CARW) program.

II. BACKGROUND AND PROCEDURAL HISTORY

San Gabriel filed its GRC Application on August 5, 2005. Administrative Law Judge ("ALJ") Barnett convened a Pre-Hearing Conference on September 29, 2005 and on November 15, 2005 in San Francisco, California. DRA filed its Motion for an Order Compelling San Gabriel to Notify its Los Angeles Division Ratepayers of the Commission's Pending Review of San Gabriel's Accounting Treatment of the Proceeds from Contamination Litigation Because of its Potential to Affect the Rates of its Los Angeles Division Customers on October 20, 2005. Judge Barnett denied DRA's motion

on October 27, 2005. The Commission convened a Public Participation Hearing on November 17, 2005 in Fontana, California. DRA, the City of Fontana, and the Fontana Unified School District submitted their Direct Testimony on November 29, 2005. San Gabriel submitted its Rebuttal Testimony on December 15, 2005. And lastly, Evidentiary Hearings were held on January 9-12th in Fontana, California and from January 18-20th in San Francisco.

On August 25, 2005, the Commission issued D.05-08-041, which granted the rehearing of D.04-07-034 pertaining to four specific issues: 1) whether San Gabriel has met its burden of proof regarding its request for a rate increase; 2) whether San Gabriel's proposed construction projects, including any changes or substitutions, are needed, reasonable and justified; 3) whether there is evidence of record supporting the finding that \$2.6million in proceeds received from the County of San Bernardino were invested in Plant F10 and whether proceeds invested in Plant F10 should also be subject to the audit ordered by D.04-07-034; and 4) whether there are special circumstances warranting San Gabriel's deviation from Standard Practice U-16, concerning working cash. All parties submitted Opening Briefs on November 10, 2005. And all parties submitted Closing Briefs on December 7, 2005. This Rehearing has been consolidated with this current proceeding, A.05-08-021. Currently, parties are still awaiting ALJ Barnett's rehearing decision.

In September 2005, the Water Division issued the Audit, ordered under D.04-07-034. The Audit found over \$27 million in net proceeds from: 1) water contamination litigation proceeds; 2) service duplication; 3) sales to private property owners; and 4) sales on condemnations should be allocated to San Gabriel's ratepayers in Fontana and Los Angeles. The Fontana Division's amount is about \$13 million. The Audit has been consolidated with A.05-08-021. San Gabriel submitted its Audit Report Response on October 28, 2005. DRA, the City of Fontana, and the School District submitted their Reply Testimony on December 9, 2005 and San Gabriel submitted its' Audit Rebuttal on December 28, 2005. Lastly, the Evidentiary Hearings in January covered the Audit issues.

The City of Fontana and the Fontana Unified School District filed their Requests for Final Oral Argument before the Commission on January 17, 2006.

On March 2, 2005, the Commission issued an Order Instituting Investigation (“OII”) on San Gabriel. This OII has been consolidated with A.05-08-021. Thus, San Gabriel is on notice that the evidence taken in these consolidated proceedings may be the basis for findings and Commission orders which, among other things, may reduce rates and order refunds. The Commission commenced the investigation to study and determine issues surrounding San Gabriel’s revenue requirement, rates, rate base, dividends, service, facilities, and maintenance practices. The OII stated no additional hearings are necessary.

The OII will address: 1) Water Division’s Audit Report; 2) whether San Gabriel’s investment of \$27,811,312 in utility plant was with funds that should have been allocated to ratepayers; 3) whether Public Utilities Code Section 790 is applicable to any portion of the \$27,811,312; 4) if the Commission finds that any portion of the \$27,811,312 should be allocated to ratepayers, should D.04-07-034’s rate base be reduced by that portion as contribution in aid of construction?; 5) If rate base is reduced, should the rates authorized in D.04-07-034 be reduced with the difference between rates in effect with D.04-07-034 and the rates found reasonable in this OII and therefore be refunded to ratepayers?; and 6) all issues raised in A.05-08-021.

III. PUBLIC PARTICIPATION HEARING

On November 17, 2005, the Commission held a Public Participation Hearing in the morning and evening in the City of Fontana. Over 500 members of the public attended the Hearing and over 60 spoke passionately and eloquently about their consistent and multitude of problems with San Gabriel Valley Water Company. The most common issues were: 1) excessive rates in comparison to neighboring areas; 2) bill inaccuracies; 3) meter malfunctions; 4) poor customer service and relations with San Gabriel.

IV. BURDEN OF PROOF

All charges demanded or received by any public utility must be “just and reasonable.” (Public Utilities Code Section 451.) Existing rates are presumed to be reasonable and lawful and a utility seeking to increase those rates has “...the burden of showing by clear and convincing evidence that it is entitled to such increase.” (Re PG&E 2000 CalPUC LEXIS 239; D. 00-02-046.) The standard applicable to the approval of rate increases is “clear and convincing” evidence:

Clear and convincing evidence must be clear, explicit, and unequivocal. It should be so clear as to leave no substantial doubt, or sufficiently strong to demand the unhesitating assent of every reasonable mind. (Re PG&E 2000 Cal PUC LEXIS 239; D. 00-02-046.)

DRA reviewed the Application submitted by San Gabriel and conducted discovery as part of its analysis and review of the rate increases sought by the Company. In numerous areas, San Gabriel’s showing is inadequate. For example, San Gabriel has not met its burden to justify various utility plant items, and certain operating and maintenance, and administrative and general expenses. DRA discusses below areas in which San Gabriel failed to meet the burden of proof of showing that its proposed rate increases for its Fontana Division are reasonable.

V. WATER SALES AND OPERATING REVENUES

DRA agrees with San Gabriel’s estimates of number of customers. DRA has estimated total sales of 19,859.7 Kccf compared to San Gabriel’s estimate of 19,549.5 Kccf. The difference between the DRA’s recommendation and San Gabriel’s position on sales to customers is from different sales projections for sales to two industrial customers: Cemex and California Steel Industries, Inc. (Ex. 45, p. 2-1) DRA also recommends that miscellaneous revenues be increased by \$116,909 to reflect additional grant proceeds for the removal of perchlorate. (Ex. 45, pp. 2-6 – 2-7) DRA’s recommended adjustments would result in what DRA views as the most likely sales levels and level of miscellaneous sales that will be experienced by San Gabriel in the 2006-2007 Test Year. Under Total Deliveries & Supply, which are the sum of metered sales, unaccounted

water, and water used in operations, the differences between San Gabriel's position and DRA's recommendation in total deliveries, water production, and sales are due to the differences in the sales forecasts for Cemex and CSI, the two large industrial customers discussed below.

Under Operating Revenues, the only difference between DRA's calculated operating revenues and San Gabriel's proposed operating revenues are attributable to DRA's higher forecast for Cemex and California Steel Industries, Inc. DRA's recommended revision to sales to Cemex, discussed below, increases projected 2006-2007 revenues at present rate by \$44,584. DRA's recommended revision to sales to CSI, also increases projected 2006-2007 revenues at present rate by \$435,781. The combined increase in forecast revenues is \$480,365 at current rates.

Under Other Revenues, which include Construction & Fire Service, San Gabriel projects Construction revenues of \$518,500 for Test Year 2006-2007 based on a five-year historical average. Revenues for Private Fire Service for Test Year 2006-2007 are \$534,000. DRA accepts San Gabriel's methodology and estimates for each category of Other Revenues.(Ex. 45, pp. 2-5 – 2-6)

San Gabriel's filing reflects projected test year 2006-2007 revenues of \$43,377,900 at present rates. DRA's adjustments for sales to Cemex and California Steel Industries, Inc., along with its recommended adjustment to miscellaneous sales, results in adjusted revenues for Test Year 2006-2007 at present rates of \$43,975,000. (Ex. 45, p.2-9) San Gabriel does not agree with DRA's adjustments for sales to Cemex and California Steel Industries, Inc. Nor does it agree with the entire amount of DRA's adjustment for miscellaneous sales, each of which will be addressed below.

A. Service Connections

Under Decision 04-06-018 (NRCP), a methodology is laid out regarding how the number of customers by customer class will be determined. DRA's review found that San Gabriel followed the guidance in the General Rate Case Plan and agrees with the number of customers, by customer class, projected by San Gabriel.

B. Annual Use By Customer Class

1. Average Use Per Customer

San Gabriel utilized the “New Committee Method,” which the General Rate Case Plan requires, to forecast sales for Residential, Commercial, Industrial-Small, Public Authority-Large, and Public Authority-Small customer classes as follows:

Residential	322.37 Ccf
Commercial	8,239 Ccf
Industrial-Small	1,199 Ccf
Public Authority-Sm	1,522 Ccf
Public Authority-Lg	6,252 Ccf

San Gabriel forecasted sales for the Large Industrial class based on a four-year average sales, with the exception to two specific customers. It calculated sales to Cemex and California Steel Industries, Inc. (“CSI”) under a different methodology, which will be discussed in the following section.

2. Sales to Cemex and CSI

In forecasting the projected sales to two large industrial customers, Cemex and CSI, San Gabriel initially utilized a 10-year average, but then reduced the 10-year average for CSI usage amount by 566,280 Ccf to reflect the impact of CSI’s projected refurbishment and use of its on-site wells to produce water for its own use. The projected reduction was based on CSI’s ownership of 1,300 acre feet of water rights. San Gabriel has provided support that CSI intends to refurbish its own on-site wells, but has not provided any support for the assumption that CSI will utilize its full 1,300 acre feet of water rights. DRA has attempted to ascertain if CSI if it intends to utilize its entire water rights, but thus far, has not been able to obtain a clear-cut answer. (Ex. 45, pp. 2-2 – 2-3) DRA witness Donna DeRonne testified that she discussed the issue with CSI. DRA agrees that CSI is rehabilitating its wells. The dispute pertains to the amount of water that CSI will begin producing for its own consumption, which is unknown at this point. (Tr. Vol. 4, p. 367-368, DeRonne/DRA)

For sales to CSI, DRA recommends projected sales be increased by 283,140 Ccf. Since San Gabriel has not provided support for its assumption that CSI will be able to and intends to pump its own water to the full extent of its owned water rights, DRA recommends that the projected sales to CSI of 566,280 Ccf be reduced by 50% ($566,280 \text{ Ccf} \times 50\% = 283,140 \text{ Ccf}$). (Ex. 45, p. 2-2 – 2-3) This increases forecast Test Year 2006-2007 revenues at present rates by \$435,800. (Ex. 45, p. 2-9)

San Gabriel sells water to Cemex on both a special contract and tariff basis, and Cemex receives both treated and untreated water for its use. DRA recommends projected sales to Cemex under tariff sales and special contract sales, be based on a two-year average using the most recent 24 months available. Company witness Michael McGraw stated in prefiled testimony that he personally contacted Cemex's plant manager to determine their water needs over the next several years. Mr. McGraw's prefiled testimony stated that the Cemex plant manager "...indicated that Cemex's water use over the next three years would remain approximately the same as it has been for the last few years." (Ex. 10, p. 13) Thus, DRA recommends a two-year average be employed instead of the 10-year average, which is more reflective of Cemex's current and anticipated usage. (Ex. 45, p. 2-3).

DRA's recommended revision to Cemex's sales increases sales from 223,666 Ccf to 250,685 Ccf and increases revenues at present rates from \$269,000 to \$313,600, an increase of \$44,600. (Ex. 45, pp. 2-3 and 2-9) Mr. McGraw again agreed in hearings that Cemex indicated that its usage would remain approximately what it had been for the last two to three years, and that he could not answer why a 10-year average usage for sales to Cemex was used in the filing. (Tr., Vol. 3, p. 273, McGraw/San Gabriel)

C. Miscellaneous and Construction Revenues

Under Miscellaneous Revenues, which are revenues recorded in Accounts 611 and 614, the revenues recorded in Account 611 consist primarily of reconnection fees collected from customers, which San Gabriel based on a five-year average in its forecast. The revenues recorded in Account 614 consist primarily of reimbursements received by San Gabriel from third parties, mainly from the County of San Bernardino. DRA accepts

the amount proposed by San Gabriel for Miscellaneous Revenues in the forecasted Test Year 2006-2007, with the exception of one revision. (Ex. 45, p. 2-6)

According to a response to a Field Visit Data Request and associated attachments to the response, in August 2005 San Gabriel received \$116,909 from the West Valley Water District, acting as a disbursement agent on behalf of the United States Environmental Protection Agency, for grant funds for the reimbursement of certain O&M costs incurred at Plant F17. The text of the response to the Field Visit Request identified that the reimbursement was associated with Plant F10. The attachments, however, stated clearly that the amounts are associated with Plant F17. The response also indicated that additional funds from the US EPA would be forthcoming. (Ex. 45, pp. 2-6 – 2-7)

The Company included a significant increase in chemical costs in its filing, \$283,568 of which is attributable to the operation of the F17 treatment facility. (Ex. 45, p. 3-4) As the large increase in chemical costs associated with the operation of Plant F17 is included in expenses, the associated grant proceeds received by San Gabriel associated with that facility should also be reflected in miscellaneous revenues. As stated in DRA's Direct Testimony, "DRA recommends Miscellaneous Revenues be increased by \$116,909 to reflect an annual level of grant revenues. (Ex. 45, p. 2-7) This would help to offset the significant increase in chemical costs being charged customers to operate the F17 treatment facility. DRA also recommends that if future grant proceeds are received by San Gabriel in excess of the \$116,909, then the excess amounts should be included in the Water Quality Memorandum Account for future benefit to ratepayers. (Ex. 45, p. 2-7)

In his rebuttal testimony, San Gabriel witness Daniel Dell'Osa indicates that this is a one-time reimbursement and agrees to adjust the Test Year forecast of other water revenues by $1/3^{\text{rd}}$ of the amount, or \$38,970. (Ex. 20, p.15) As previously indicated, the attachment to the Company's Data Response indicated that additional US EPA funds would be forthcoming. Thus, contrary to San Gabriel's position, these funds will continue to be paid to San Gabriel on an annual basis. Within the rebuttal testimony of San Gabriel witness Frank LoGuidice, he indicates that the Company agrees that any

chemical costs related to resin replacements at Plant F17 should be offset by any grant funds the Company receives for plant F17. (Ex. 21, p. 4)

VI. OPERATING AND ADMINISTRATIVE EXPENSES

A. Supply Costs

1. Unmetered and Unaccounted for Water

Unaccounted water is the amount of water lost through operations and leakage and is calculated as the difference between the total amount of water produced and the total amount of potable water recorded for sales. DRA agrees with San Gabriel's proposed 6.2% unaccounted for water factor, which is based on a 5-year average amount, is less than the amount included in the Company's prior rate case, and is reasonable as compared to other utilities. (Ex. 45, p. 2-4)

2. Recycled Water- N/A

3. Water Costs

DRA has reached an agreement with San Gabriel that its proposed \$8,509,500, resulting in a composite amount of \$177.88/AF, forecast for Test Year 2006-2007 is reasonable. DRA reviewed the projected level of water to be purchased and the assumptions included in the filing regarding the costs of water, including the review of current rates being charged from outside parties. The proposed cost includes water lease costs, assessments imposed by the Chino Basin Watermaster on water produced from the Chino Basin, assessments levied on Fontana Union Water company stock, assessments imposed by the Inland Empire Utilities Agency, purchased State Water Project water and purchased Cucamonga Valley Water District Water costs. The workpapers provided by the Company in support of the costs included detailed information such as invoices and letters from vendors supporting its estimates. As DRA has recommended an adjustment to increase the Company's projected sales to California Steel Industries, Inc. by 650 acre feet, DRA has also increased the projected purchase water costs by \$115,622 (650AF x \$177.88/AF) for the average increase in water costs attributable to that adjustment. (Ex. 45 at 3-3) The actual purchased water costs go through a full cost balancing account.

4. Purchased Power Costs

DRA has reached an agreement with San Gabriel that its proposed \$4,659,500 or \$0.094782/kWh forecast for Test Year 2006-2007 is reasonable. The actual purchased power costs for the Company go through a full cost balancing account.

5. Chemicals Expense

San Gabriel estimates that its annual chemical expense will increase from the actual 2004 amount of \$140,544 to TY 2006-2007 cost of \$680,100, an increase of 384%. The forecasted increases are due to the resin replacement at Plant F17 beginning in 2005 and the projected additional costs beginning in 2007 for chemicals associated with the Sandhill Treatment Plant upgrade.

The treatment facility at Plant F17, which is an ION exchange facility used for the removal of perchlorate, went into service in 2003, and was set for its first resin replacement in 2005. San Gabriel provided an actual invoice to DRA for resin replacement for Plant F17 at \$283,568, which was used to project the future replacement costs. DRA concurs with San Gabriel on the amount included in the filing for chemical costs for Plant F17. (Ex. 45 at 3-4)

DRA, however, does recommend that grant funds received by San Gabriel for the treatment cost reimbursement at Plant F17 of \$116,909 be included in Miscellaneous Revenues, as addressed previously, which would help offset projected chemical costs. Additionally, if the Company receives future reimbursements or grant funds for Plant F17 or for perchlorate treatment cost reimbursements in general in an annual period in excess of the \$116,909 DRA recommends including in Miscellaneous Revenues, then San Gabriel should be required to include the receipts of the amounts in excess of the \$116,909 in the Water Quality Memorandum Account. (Ex. 45 at 3-5) These grant proceeds were discussed in greater detail previously in this brief under Miscellaneous Revenues.

For the Sandhill Treatment Plant Upgrade, San Gabriel included projected chemical expenses for the 2006-2007 Test Year based on 50% of projected 2006

expenses of \$148,872 and 50% of the projected 2007 expenses of \$404,107. San Gabriel based the projected 2007 increase on the estimated chemical costs to operating the upgraded plant based on Cucamonga Valley Water District's experience with operating a similar water treatment plant. (Ex. 45, p. 3-5)

In response to discovery by DRA, San Gabriel indicated that the projected in-service date for the Sandhill Plant upgrade is not until August 2007 which is after the end of Test Year 2006-2007. Thus, DRA recommends that the Chemical Costs for the Sandhill plant for Test Year 2006-2007 be based on San Gabriel's projected 2006 pre-upgrade cost of \$148,872, resulting in a \$128,000 reduction to San Gabriel's proposed Chemical Expense. (Ex. 45, pp. 3-5 – 3-6)

B. Other Expenses

1. Escalation Factors

For the majority of the Operation & Maintenance expenses and Administrative & General expenses, other than payroll, San Gabriel forecasted expenses utilizing a five-year average of recorded data from 2000-2004, adjusted to 2004 dollars, and applied escalation factors in determining the future amounts.

In inflating historic costs to 2004 dollars to determine the five-year average level, and in applying escalation factors for the Test Year and escalation years, San Gabriel utilized June 30, 2005 publications from the DRA Energy Cost of Service Branch ("ECSB"). DRA recommends that San Gabriel should utilize a more recent ECSB memorandum, dated September 30, 2005 to update the inflation factors, and San Gabriel has agreed to this recommendation. DRA's recommendations contained within its report (Exhibit 45) for the costs impacted by the escalation factors are based on the September 30, 2005 updated factors. The updated factors, based on the September 30, 2005 DRA Energy Cost of Service Branch Escalation memorandum, are as follows:

INFLATION RATES (%) TABLE (calendar year)

YEAR	NON- LABOR	LABOR	COMPENSATION PER HOUR	COMPOSITE 60/40 SPLIT
2000	3.5	2.2	6.9	4.9

2001	0.0	3.4	2.7	1.1
2002	0.0	2.8	2.8	1.1
2003	2.5	1.6	4.0	3.1
2004	5.8	2.3	4.5	5.3
2005	5.4	2.7	5.6	5.5
2006	1.2	3.5	4.0	2.3
2007	0.0	2.3	4.2	1.7
2008	0.0	1.5	4.4	1.8
2009	0.2	1.9	4.5	1.9

(Ex. 45, pp. 3-1 – 3-2)

2. Materials and Supplies Expense

DRA did not take issue with the projected amount of Materials & Supplies Expense included by San Gabriel in its filing, which was based predominately on the five-year average expense levels, escalated to Test Year dollars. The cause of the differences between the DRA recommended materials and supplies expense amounts and those proposed by San Gabriel for Test Year 2006-2007 is due to DRA's use of the updated, September 30, 2005 escalation factors. DRA's report included the following amounts for materials and supplies expenses: \$142,300 for operations, \$282,900 for maintenance and \$40,300 for administrative and general. These amounts are \$1,500, \$3,100, and \$400 higher than San Gabriel's proposed amounts, respectively. (Ex. 45, pp. 3-18 and 4-8)

3. Transportation Expense

San Gabriel's projected Test Year 2006-2007 Operations & Maintenance expenses include \$628,306 for transportation expenses. San Gabriel projected this amount based on the application of both the projected non-labor escalation rates and an additional 1% escalation increase each year from 2005-2007. The Company indicated that the additional 1% increase is added each year to "adjust for the purchase of additional vehicles." (Ex. 8, p. 12) Based on discussions with Company employees, however, San Gabriel has not based the 1% on any calculations or studies. Thus, there is no support for the additional 1% increase factor proposed by San Gabriel. (Ex. 45, p. 3-12) DRA recommends a Test Year 2006-2007 expense of \$619,323, which is a reduction of

\$8,983. The differences between DRA's recommendation and San Gabriel's projection are the replacement of San Gabriel's escalation factors with the September 30, 2005 factors previously discussed above and the removal of the additional 1% annual increases. (Ex. 45, p. 3-12)

4. Postage

In projecting Test Year 2006-2007 postage expense, the Company applied non-labor escalation rates as well as the 5.4% postage rate increase. For postage associated with mailing to customers, recorded in Account 773, the Company also adjusted for the level of projected customer growth contained within the filing. (Ex. 8, p. 16) DRA concludes the Company's methods are reasonable. The only difference between DRA and the Company was the application of updated escalation factors previously discussed.

5. Outside Services Expense – Other Than Legal Expenses

a) Maintenance Expense – Outside Services

San Gabriel has projected the Test Year 2006-2007 maintenance expense – outside services cost to be at \$187,100. For the majority of the subaccounts included in its proposed Maintenance Expense – Outside Services, San Gabriel based the estimates on amounts that differed from the five-year average expense level escalated to Test Year amounts. According to Mr. Dell'Osa's testimony, the expenses in subaccounts 732, 761, 763, 765 and 766 vary directly with the quantities of physical plant. San Gabriel estimated the costs for these accounts based on the 2004 recorded costs increased for future years by the increases in the number of wells, feet of mains, number of service connections, or number of hydrants, in addition to the compensation per hour inflation rates. (Ex. 45, p. 3-14 and Ex. 8, p. 13) DRA recommends several revisions to San Gabriel's projected amounts.

When it forecasted the projected cost for outside services in Account 732 – Maintenance Pumping Equipment, San Gabriel first divided the actual 2004 expense by the number of wells operating in 2004 to determine an average cost per well. San Gabriel escalated this cost using the Compensation per Hour escalation factor, then applied the

escalated per-well cost to its projected number of wells for 2006 and 2007, resulting in a Test Year 2006-2007 amount of \$57,982. DRA has revised this calculation to reflect our recommendation that only one new well be added, as discussed in Chapter 8 of Exhibit #45. In addition, DRA recommends replacing San Gabriel's proposed Compensation per Hour escalation factor with the more recent escalation rates previously discussed. This lowers DRA's recommended amount of \$52,126 for outside services – Maintenance Pumping Equipment. (Ex. 45, p.3-14)

San Gabriel also increased its projected Outside Services costs in Account 732- Maintenance of Pumping Equipment by an additional \$17,294 for the projected maintenance costs associated with its proposed nine new emergency generators. The amount was based on a projected annual maintenance cost per emergency generator, escalated to Test Year amounts using the Compensation per Hour escalation factors. DRA recommends that only five emergency generators be allowed, as discussed in Chapter 8 of Exhibit #45. Based on the recommendation of five emergency generators, and the revision of the escalation rates to reflect the more recent rates previously discussed, DRA has reduced San Gabriel's proposed amount of \$17,294 to \$9,557. (Ex. 45, p. 3-15)

For Accounts 761 – Maintenance of Mains, 763 – Maintenance of Services, and 765 – Maintenance of Hydrants, San Gabriel divided the 2004 actual costs in these accounts by the number of feet of mains, service connections and hydrants, respectively. San Gabriel then escalated these amounts using its proposed escalation factors and applied the resulting amounts to the projected number of feet of mains, service connections and hydrants in 2006 and 2007. For Account 766 – Maintenance of Miscellaneous Plant, San Gabriel used the 2004 per book amount and escalated it to Test Year 2006-2007 dollars using its proposed escalation factors.

San Gabriel's testimony indicates that these sub-accounts were projected in this manner as the expense levels vary directly with the quantities of physical plant. However, this has not been the case for San Gabriel. Based on a review of the Outside Services sub-accounts for each of these accounts, the actual expense has fluctuated both

up and down in each of the accounts over the last five years. While the feet of mains, number of connections, and number of hydrants has increased every year over the last five years, the cost has both decreased and increased over the five-year period. The accounts do not show a steady increase, a result one would expect if San Gabriel's assumptions were correct. Thus, DRA has revised the costs in these accounts to be based on the five-year average expense level, inflated to 2004 dollars, and escalated to Test Year 2006-2007 using the more recent Compensation per Hour escalation factors previously discussed. (Ex. 45, p. 3-15 to 3-16)

DRA's recommended revisions to Maintenance Expense – Outside Services results in an adjusted Test Year 2006-2007 amount of \$177,200, which is \$9,900 less than the amount proposed by San Gabriel. (Ex. 45, pp. 3-16 and 3-18)

b) Miscellaneous O&M Expense

The O&M expenses in San Gabriel's filing include \$73,600 for Miscellaneous Expenses. With the exception of one account, San Gabriel's projection of Miscellaneous Expense is based on the five-year average level using the years 2000 through 2004, inflated to 2004 dollars, then escalated into the 2006-2007 Test Year using the June 30, 2005 escalation factors. For Account 748-00 – Maintenance of Water Treatment Equipment – Miscellaneous, San Gabriel reduced the 2004 recorded amount from \$229,364 to \$24,807 to remove one-time expenses associated with water sampling including the installation of a packer in four wells. (Ex. 45, p. 3-16)

After San Gabriel's adjustment to Account 748-00, the remaining balance in the account of \$24,807 for 2004 remains considerably higher than prior years and considerably higher than actual 2005 year to date expenditures recorded in the account. The expense in Account 748-00 for the years 2000 through 2003 were \$96, \$3,721, \$5,888, and \$3,564, respectively. The actual expense recorded in the account for 2005 through August was \$2,929. (Ex. 45, p. 3-16)

DRA recommends that the calculation of the expense for Account 748-00 – Maintenance of Water Treatment Equipment – Miscellaneous, be based on the four-year average level, 2000 through 2003, inflated to 2004 dollars, then escalated to Test Year

2006-2007 levels. This would fully remove the non-recurring costs instead of only partially removing them as San Gabriel has done. This results in Test Year 2006-2007 expense in this account of \$3,900, which is \$4,500 less than the amount proposed by SGVWC of \$8,400. (Ex. 45, p. 3-16)

After revising the projected Test Year 2006-2007 costs for Maintenance of Water Treatment Equipment – Miscellaneous and flow through of the updated escalation factors based on ECSB’s September 30, 2005 Memo, DRA’s recommended Miscellaneous Expenses are \$69,800, or \$3,800 less than San Gabriel’s proposed amount. (Ex. 45, p. 3-17 and 3-18)

6. Outside Services – Legal Expenses

a) Non-Perchlorate-Related Legal Expenses

The Company’s filing included \$287,795 in Test Year 2006-2007 for non-perchlorate related legal costs, included in Administrative and General – Miscellaneous Expenses. San Gabriel determined non-perchlorate related legal costs based on a ten-year average expense level, inflated to 2004 dollars, then escalated to Test Year 2006-2007 utilizing the June 2005 escalation factors. (Ex. 45, p. 4-6 and Ex. 12, p.13)

The annual level of non-perchlorate related legal costs, as well as the annual amounts inflated to 2004 dollars, for each of the ten years used by San Gabriel in determining its projected cost is contained in Exhibit 84. That exhibit clearly shows that the escalated cost for the two oldest years, 1995 and 1996, are significantly higher than any of the other years reflected. Company witness Michael Whitehead agreed that these two years were higher than the other years used in the 10-year average. (Tr. Vol 8, p. 756, Whitehead/San Gabriel) DRA reviewed the legal costs included in each of the ten years included in the average calculations and determined there was a significant impact from the two most historic years causing the 10-year average calculation to not be reflective of going-forward cost estimates. (Tr. Vol. 4, p. 374, DeRonne/DRA)

DRA recommends that the non-perchlorate related legal costs be revised to be based on a five-year average level, inflated to 2004 dollars and escalated to the 2006-

2007 Test Year level using the updated, September 30, 2005 escalation factors. This is more consistent with the 5-year averaging methodology used for other accounts and removes the impact of the abnormal cost levels contained in the two most historic years used by San Gabriel in the 10-year average. This results in DRA's recommended non-perchlorate related legal costs of \$151,972, which is \$135,824 less than the amount proposed by the Company. (Ex. 45, p. 4-6) Moreover, DRA questions the reasonableness of relying on expenses incurred at least a decade ago, to forecast future expenses.

b) Perchlorate-Related Legal Expenses

Perchlorate related legal expenses are current accounted for through the Water Quality Litigation Balancing Account and are not factored into base rates. DRA recommends that this methodology continue, and that amounts recorded in the Water Quality Litigation Balancing Account continue to be deferred until the outcome of the associated legal expenditures and litigation are known. (Ex. 45, 13-1 – 13-2) This is discussed further under the heading "XI.B. Memorandum Accounts – 1. Water Quality Litigation Memorandum Account"

7. Utilities and Rents Expense

San Gabriel's Operations & Maintenance expenses for Test Year 2006-2007 include \$88,200 for Utilities and Rents, based on the actual 2004 amount, escalated to the Test Year level. Replacing the actual 2004 amount with the five-year average level (inflated to 2004 dollars) and escalated to the Test Year 2006-2007 while using San Gabriel's proposed escalation factors results in a Utilities and Rents expense of \$88,892, which is slightly higher than the \$88,200 requested by San Gabriel based on the 2004 escalated level. DRA concurs that San Gabriel's use of actual 2004 amounts, as escalated, for Utilities and Rents is reasonable. DRA's recommended amount for Utilities and Rents is \$89,100. The difference between DRA's recommended amount and that proposed by San Gabriel is due to DRA's use of more recent escalation factors. (Ex. 45, p.3-13 – 3-14). San Gabriel's Administrative and General Expenses include \$2,200

for utilities and rent expense. DRA agrees this amount is reasonable and the use of the updated escalation factors did not impact the rounded cost. (Ex. 45, p. 4-8)

8. Labor Costs

San Gabriel's filing included proposed payroll expense for the Test Year 2006-2007 of \$5,061,200. In projecting payroll expense, San Gabriel began with the actual employee monthly salaries as of June 1, 2005. It added all vacant positions as of that date as though they were completely filled and added many proposed new employee positions in addition to the existing and vacant positions. The resulting amounts were escalated to the Test Year 2006 – 2007 by applying the June 1, 2005 ECSB Compensation per Hour Index, and many positions were also increased by step increases.

DRA's recommended payroll expense for Test Year 2006-2007 is \$4,516,000, a reduction of \$545,200 from the Company's filing. In determining the recommended payroll expense, DRA made the following revisions to San Gabriel's calculations: 1) removed eleven (11) positions that were vacant as of November 14, 2005; 2) replaced the Compensation per Hour Index with ECSB's labor inflation rates published in September 2005; 3) removed the step increases; 4) replaced wages for newly filled positions with the actual granted salary amounts; 5) removed five of the twelve (12) proposed new positions; and 6) removed four additional proposed new Water Treatment Operator IIIs and recommended Advice Letter recovery for these four new positions. (Ex. 45, p. 3-12)

a) Existing Positions

The payroll calculations used by San Gabriel in projecting the Test Year 2006-2007 payroll expense assumes that all of its existing vacant positions were filled. As of the date the filing was prepared, San Gabriel had thirteen (13) vacant positions. As of November 14, 2005, twelve (12) of the existing positions included in the filing were vacant. DRA recommends that the twelve positions that were vacant as of November 14, 2005 be removed in determining Test Year 2006 – 2007 payroll expense. The vacant positions should be excluded in determining projected payroll expense as it is normal to have some level of vacancies in any given period. In addition, for new employees that had been hired

from the date of the Company's filing through November 14, 2005, DRA replaced the projected salary included in the filing with the actual amount. (Ex. 45, p. 3-7)

DRA's recommendation to remove the vacant positions is consistent with the Commission's decision in the recent Los Angeles Division rate case, D.05-07-044. In that decision, the Commission did not include the vacant positions, indicating that adjustments should not be made for temporary vacancies absent a showing of extraordinary circumstances. The decision also indicated that most utilities will have vacancies and "To the extent there were vacancies in the recorded year, we should assume there will also be comparable vacancy savings in the test year and escalation years." (Ex. 45 at 3-7 and Ex. 49)

During hearings, Company witness Robert Nicholson agreed that "At any given time there are bound to be some vacancies." He also indicated that he believed the levels in May and November of 2005 were higher than normal for the Company. (Tr. Vol. 4, p. 306, Nicholson/San Gabriel) However, when asked about the change in the number of employees since November 1995, he was not sure during the hearings, other than indicating that he could think of one retirement. (Tr. Vol. 4, p. 307, Nicholson/San Gabriel)

In Exhibit 50, the Company provided an update indicating that the net change in the number of employees from November 14, 2005 to January 16, 2006 had been an increase of one employee. Clearly the Company has not filled all thirteen positions that were vacant as of its application being filed, nor has it filled the twelve positions that were vacant as of the time the DRA determined its proposed payroll expense. Consistent with the prior Los Angeles Division decision, the Commission should once again remove the vacant positions so that rates will be set based on a realistic on-going employee compliment, while acknowledging the fact that vacancies are a normal occurrence.

b) New Positions

In addition to assuming that all vacant positions would be filled by the start of the Test Year, the Company has also included costs in its filing associated with twelve new

proposed positions. The proposed new positions, along with the projected hire by dates included in the filing, are as follows:

- Safety Specialist (July 2006);
- Customer Serviceman (January 2007);
- Meter Reader (January 2007);
- Water Treatment Supervisor (July 2006);
- Six (6) Water Treatment Operator IIIs (July 2006);
- Plant Maintenance Man A (January 2007); and
- Water Treatment Operator I (July 2006). (Ex. 45, pp.3-7 – 3-8)

DRA recommends that five of the proposed twelve new positions be removed, consisting of: two of the six proposed new Water Treatment Operator III positions; new meter reading position; new customer serviceman; and new Water Treatment Superintendent. For the remaining four (4) Water Treatment Operator III positions that DRA recommends allowing, DRA recommends the associated costs be removed from the determination of the Test Year 2006-2007 costs and be allowed for recovery via Advice Letter after (and if) the Sandhill Treatment Plant upgrade is up and running and the positions are actually filled. (Ex. 45, pp. 3-7 – 3-12) The specific rationale for removing each of these positions are addressed below.

Water Treatment Operator III Positions

As of June 1, 2005, San Gabriel employed five Water Treatment Operator IIIs and four Water Treatment Operator IIs to staff the Sandhill Water Treatment plant. As of November 14, 2005, San Gabriel employed only four Water Treatment Operator IIIs. The Company's filing also included two vacant Water Treatment Operator III positions in addition to the filled positions. The Company's proposed addition of six new Water Treatment Operator III positions, combined with the vacant positions included in the

filing, would increase the water treatment operators staffing the Sandhill Water Treatment Facility from 8 to 17, more than doubling the current number. (Ex. 45, p. 3-8)

The California Department of Health Services provided a letter to San Gabriel indicating that the Company will be required to staff the Sandhill Plant, after the upgrades are complete, with two certified Water Treatment Operators with Grade III certification or above for 24 hours a day, seven days a week. The Sandhill Water Treatment plant currently is not staffed from 12PM to 7AM, and on Saturdays and Sundays only one individual is employed for 8 hours each day. (Ex. 45, p.3-8)

DRA recommends that two of the proposed new Water Treatment Operator III positions be removed, allowing for an increase of four new Water Treatment Operator III positions. Two full time positions will be needed to staff the plant on weekdays during the hours the plant currently is not staffed, 12PM – 7PM. Additionally, by revising the work schedules, two additional full time positions should be adequate to ensure the new post-upgrade staffing requirements are met on weekends. The Company has not justified the need to more than double the existing Water Treatment Operators needed to staff the Sandhill Water Treatment Plant. (Ex. 45, pp. 3-8 – 3-9)

Additionally, DRA has not recommended that the four new Water Treatment Operator III positions be removed in their entirety. Instead, DRA does recommend that the costs associated with those positions be removed from base rates and recovered via Advice Letter after (and if) the Sandhill Treatment Plant is in operation and the positions are actually filled. The Company has included these positions in its application as though they are hired before July 2006, the start of the 2006-2007 Test Year. The Company has indicated that the Sandhill Water Treatment Plant upgrade will not be in-service until August 2007. This date falls outside of Test Year 2006-2007. Thus, the associated payroll costs should not be included in the 2006-2007 Test Year. (Ex. 45, p. 3-9)

Meter Reader Position

DRA recommends the new meter reading position proposed by San Gabriel be removed for several reasons.

The Company had seven meter readers from 2000 to 2003 and added an additional meter reader in 2004. The average number of metered customers per meter reader was 4,974 in 2000; 5,154 in 2001; 5,332 in 2002; 5,562 in 2003; and 5,049 in 2004. The proposed new position would result in average Test Year 2006-2007 metered customers per meter reader of 4,844. The Company has not demonstrated that this level of meter readers is necessary. (Ex. 45, p. 3-10)

Meter readers read 148 routes a month. The Company forecasts adding four new routes over the next three years, an increase in routes of 2.7%. The Company has not demonstrated that an additional meter reading position is needed to meet the forecast route requirement, particularly since a new meter reader was recently added in 2004. (Ex. 45, p. 3-10)

An additional reason for not excluding the additional meter reading position from rates is that under the Commission's adopted Rate Case Plan, in addition to the general labor escalation factor, the Company will also be permitted to escalate labor costs in the escalation years by a customer growth factor. *See* D.04-06-018. The application of this factor in addition to the labor escalation factor should more than adequately cover the impacts of the increasing customer base on payroll costs. (Ex. 45, p. 3-10)

Customer Serviceman Position

The Company has not justified in its filing the need for an additional Customer Serviceman beginning in 2007, nor has it shown that the existing level of Customer Servicemen is not adequate. The Company has cited heavy workload when existing employees are off for injury, illness or vacations. The payroll projections contained in the application include an overtime factor of 2.6% based on the 2004 actual overtime level, which the Company has not adjusted to reflect the impact of the new positions it is

proposing to add. Additionally, DRA's review of the customer compliant forms and bill inquiry forms indicate that the currently existing Customer Servicemen have promptly responded to complaints and bill inquiries. (Ex. 45, pp. 3-10 – 3-11)

Furthermore, as discussed above under Meter Reader positions, under the General Rate Case Plan, the Company will be permitted to escalate labor costs in the escalation years by both the labor escalation factor AND a customer growth factor. This should adequately cover the impacts of the increasing customer base on payroll costs. (Ex. 45, p. 3-11)

Water Treatment Superintendent

DRA recommends that the new water treatment superintendent position also be removed. One of the reasons provided by San Gabriel for adding this position is that it must have a Grade 5 Water Treatment Operator on staff and two current Grade 5 Water Treatment Operators will be retiring in April 2006. The Company did not remove these retiring positions from its application, and DRA has not removed them assuming they will be replaced. Since the two employees retiring, which were supposed to justify the need for the new Grade 5 Water Treatment Operator were not removed from the application, the costs associated with this position should be excluded. Additionally, the Company has not demonstrated that the current level and structure of positions can not meet projected oversight and supervisory requirements. (Ex. 45, pp. 3-11 – 3-12)

c) Employee Step Increases

In addition to applying the ESCB's compensation per hour index to the June 1, 2005 salaries, discussed in the following section, San Gabriel has also included step increases for numerous positions. This results in an overstatement of labor expense. The Company followed this same approach in the recent Los Angeles Division General Rate Case. In the decision in that case, D. 05-07-044, at page 10, which was provided as part of Exhibit 49, the Commission determined that the step increase should be removed. DRA recommends that the step increases be removed, allowing only for the application

of the September 30, 2005 ESCB labor escalation factors in escalating the actual June 2005 salary and wage expense. (Ex. 45, p. 3-7)

At hearings, San Gabriel witness Robert Nicholson read parts of the decision from the Los Angeles Division rate case, D. 05-07-044, into the record, and agreed that the decision disallowed step increases. However, the witness disagreed with this finding, and indicated that step increases are routine. (Tr. Vol. 4, p. 304, Nicholson/San Gabriel) Mr. Nicholson agreed that from time to time employees who have reached the top or close to the top of their scale rate of pay may leave the company and they would be replaced by employees starting at the bottom of the salary scale. (Tr. Vol. 4, p. 304 – 305, Nicholson/San Gabriel)

At hearings, DRA witness Donna DeRonne provided the following discussion regarding why step increases should not be granted in addition to the labor escalation increases:

“One big reason for not allowing the step increases in addition to those labor escalation factors is at any given point in time the company has turnover in its employee staff. You’ll have employees leaving that might be tapped out at the step scale, but they’re replaced by employees at the lower scale. So it’s ORA’s view and my view that the labor escalation factors should result in a reasonable going-forward labor expense and what’s likely to be incurred during the first rate period in this case.”

(Tr. Vol. 4, p. 368-369, DeRonne/DRA)

Step increases should not be granted in addition to the labor escalation increases. Essentially, labor escalation already covers these expenses; allowing specific recovery for step increases would allow San Gabriel to collect for expenses it will not likely actually incur.

d) Escalation Factors

The starting point of the Company salary calculations was the actual employee monthly salaries as of June 1, 2005. In escalating the June 1, 2005 amounts, San Gabriel applied the Compensation per Hour Index published by the DRA’s Energy Cost of

Service Branch (ESCB) in June 2005. DRA recommends that this index be replaced with the ESCB's labor inflation rates as of September 30, 2005.

The Compensation per Hour Index utilized by San Gabriel is applicable to contract services, not employee labor. This same issue was addressed in San Gabriel's recent Los Angeles Division general rate case in which the Company utilized the Compensation per Hour Index instead of the labor escalation rate. In the resulting Decision, D. 05-07-044, at page 10, the Commission determined that ESCB's labor inflation rates should be used, not the compensation per hour index. (Ex. 45, p. 3-6 – 3-7) San Gabriel has agreed with DRA that the ECSB labor inflation rates should be used instead of the Compensation per Hour Index, indicating the impact as a \$330,000 reduction to Test Year 2006-2007 revenue requirement. (Ex. 20, pp. 25-26)

9. Employee Pensions and Benefits

a) Vacation, Holidays and Sick Leave

San Gabriel proposed \$828,000 for payroll expenses related to vacation, holiday, and sick leave. After applying DRA's recommended revisions to payroll costs discussed above, vacation, holiday, and sick leave expenses total \$738,000, a reduction of \$90,000 from San Gabriel's proposal. (Ex. 45, p. 4-4) While the Company does not agree with all of DRA's recommended payroll adjustments, they do agree that the methodology used by DRA to determine the impact of its recommended payroll adjustments on the vacation, holiday and sick leave costs is correct. (Ex. 20, p. 16)

b) 401(K) costs

After application of its expense factor, San Gabriel calculated \$301,639 for 401(K) expenses for the 2006-2007 Test Year. The amount was calculated based on the estimated 2005 Company contribution rate of 7.34%, increased into the 2006-2007 Test Year for the Compensation per Hour Index from ECSB's June 30, 2005 Memo and the addition of payroll dollars for the filling of vacant positions and proposed new positions.

DRA agrees San Gabriel's use of the 7.34% contribution factor is reasonable. As discussed in the payroll section, above, DRA recommends that the vacant positions be

removed, the majority of the new positions be removed, and the escalation factor be changed from the Compensation per Hour Index to the Labor Inflation Rate from ECSB's September 30, 2005 Memo. DRA's recommendation results in a recommended pension expense, after application of the expense factor, of \$254,522, which is \$47,118 less than the amount proposed by SGVWC. (Ex. 45, p. 4-4)

c) Health Insurance

For health insurance expenses, San Gabriel inflated the 2005 premiums for its two health plans by an assumed increase of 14.19%. Additionally, San Gabriel's calculations factored in the impact of four new employees becoming eligible for health insurance benefits in 2005 and included projected health insurance costs for the vacant and new positions it has added in its payroll calculations. DRA agrees with San Gabriel's forecasts and methodology for projecting health insurance expense, with the exception of the impact of DRA's adjustment for the number of employees. DRA recalculated the health insurance expense to reflect the impact of our recommended removal of the vacant positions from the filing and the removal of the new positions DRA is removing in payroll calculations. The impact is a \$45,019 reduction to San Gabriel's projected health insurance expense. (Ex. 45, p. 4-5)

d) Dental Insurance

San Gabriel projected dental insurance expenses by inflating the 2005 premiums for its two health plans by an assumed increase of 6%. Additionally, San Gabriel's calculations factored in the impact of five new employees becoming eligible for dental insurance benefits in 2005 and included projected dental insurance costs for the vacant and new positions it has added in its payroll calculations. DRA agrees with San Gabriel's forecasts and methodology for projecting dental insurance expense, with the exception of the impact of DRA's adjustment for the number of employees. DRA recalculated the dental insurance expense to reflect the impact of our recommended removal of the vacant positions from the filing and the removal of the new positions DRA is removing in

payroll calculations. The impact is a \$4,000 reduction to San Gabriel's projected dental insurance expense. (Ex. 45, p. 4-5)

10. Injuries and Damages

San Gabriel's projected Test Year 2006-2007 Injuries & Damages and property insurance expense is \$626,600. This includes costs for umbrella insurance policy covering general liability, automobile liability and property damages, and workers compensation expense. Of the total \$626,600, \$12,300 is included for property insurance, \$390,000 is included for workers compensation insurance, and the remainder is for liability. (Ex. 45, p. 4-1 – 4-2) Each of these will be discussed below.

a) Business, Property and Umbrella Liability Insurance

San Gabriel's filing includes \$236,600 for non-workers compensation (\$626,600 total amount - \$390,000 for workers compensation) related injuries and damages costs, consisting of business, property and liability insurance. In determining the costs associated with the umbrella insurance policy covering general liability, automobile liability and property damages, San Gabriel's Test Year 2006-2007 estimate was based on the actual 2005 invoiced amount, escalated by 10% for 2006 and 2007. The 10% escalation rate was provided to San Gabriel from its insurance broker. The 10% escalation rate is consistent with insurance cost escalations DRA's consultants have seen in recent years, and DRA finds the factor to be reasonable. DRA accepts San Gabriel's projected umbrella insurance policy costs. (Ex. 45, pp. 4-1- 4-2)

b. Workers' Compensation Insurance

Workers Compensation insurance, totaling \$390,000 on a Fontana Division expense basis, helps comprise San Gabriel's projected Injuries and Damages expenses. San Gabriel's projected increase in Workers Compensation insurance expense incorporates two factors. The first factor increasing the cost is associated with the impact of San Gabriel's projected overall increase in payroll costs.

Secondly, workers compensation insurance expense is increased due to certain assumptions made by San Gabriel regarding its experience modification factor (ExMod).

The ExMod is a percentage factor applied to the determined premiums, which either raises or lowers the premium for individual companies. According to San Gabriel, its insurance broker calculated that San Gabriel's ExMod will increase from 83% to 92% effective July 1, 2005. This is an increase of 10.8%, which will increase the Company's workers compensation insurance premium by the same percentage. In its calculations for the following plan year, the year beginning July 1, 2006, San Gabriel increased the ExMod factor to the full 100%. While San Gabriel did provide supporting documentation in response to discovery supporting the 92% ExMod factor calculated by its insurance brokers, nothing was provided by San Gabriel in support of its assumption that the factor will increase to the full 100%. The 100% ExMod factor is inconsistent with actual experience for San Gabriel and inconsistent with the insurance broker's projections. (Ex. 45, p. 4-2) During hearings, Company witness Robert Nicholson indicated that the most recent actual experience modification factor the Company was subject to was 92%. He also indicated that there is not a specific reason that he feels the Company's experience modification rate will worsen. (Tr. Vol. 4, p. 310, Nicholson/San Gabriel)

DRA recalculated the projected workers compensation insurance expense, using a similar methodology, which was employed by San Gabriel, with a few modifications. First, DRA replaced the Company's projected percentage increase in overall payroll costs with the overall percentage of payroll cost increase recommended by DRA based on our payroll adjustments previously discussed. Second, DRA removed the Company's projected increase from 92% to 100% in the ExMod factor, reflecting the most recent actual ExMod factor for the Company of 92%. The result is a recommended Test Year 2006-2007 workers compensation insurance expense, on a Fontana Division expense basis, of \$333,600, which is \$56,400 less than the amount proposed by San Gabriel. (Ex. 45, pp. 4-2 – 4-3)

Additionally, over each of the last three years, San Gabriel has received refunds of its workers compensation expense payments. These refunds have been booked by San

Gabriel in Account 00-401-00 – Miscellaneous Credits to Surplus. At year end, the Company closes the balance in the Miscellaneous Credits to Surplus to Account 00-271-00 – Earned Surplus, which impacts retained earnings. The refunds that have been received by San Gabriel are not factored into the workers compensation expense calculations as they are not credited to the expense accounts on the Company's books. The annual refunds for each of the last three years for the Fontana Division were \$1,754 booked on February 28, 2005, \$51,150 booked on January 31, 2004 and \$17,988 booked on January 31, 2003. As ratepayers pay the costs of workers compensation insurance in rates, they should also receive the benefit of the refunds received by San Gabriel for such insurance costs. DRA recommends that the workers compensation expense be offset by the three-year average of refunds received, or \$23,631. (Ex. 45, p. 4-3)

DRA's recommendations result in an adjusted Injuries & Damages Expense of \$534,300, which is \$80,000 less than the amount included in the filing. The \$80,000 includes the recommended \$56,400 reduction to workers compensation expense to reflect DRA's payroll increase and 92% ExMod factor, and the \$24,000 reduction to reflect the three-year average amount of refunds received.

11. Regulatory Commission Expense

San Gabriel's filing includes Test Year 2006-2007 Regulatory Commission Expenses of \$191,400. Included in the Regulatory Commission Expense is \$187,333 for the amortization over three years of San Gabriel's projected costs for this rate case of \$562,000. (Ex. 6, p. 19) Included in the \$562,000 projected cost is \$390,000 for outside legal fees. (Ex. 6, Attachment G) DRA originally recommended in its report, Exhibit 45, that 50% of the outside legal fees be excluded as it appeared at that point that many of the issues in this case would settle. The anticipated settlements did not come to fruition. As a result, the Company incurred legal costs associated with the conduct of full hearings in this case. Based on this, DRA agrees the Company's originally projected regulatory commission expense in this case of \$562,000, amortized over a three-year period for

\$187,333 annually, is reasonable. The impact of this revision to the DRA's original position is reflected in Joint Exhibit 88.

12. Uncollectibles and Franchise Fees

In its filing, San Gabriel projected uncollectible expenses based on a five-year average uncollectible rate of 0.2850%. San Gabriel's uncollectible rate for each of the five years were as follows:

2000	– 0.3880%
2001	– 0.3630%
2002	– 0.3345%
2003	– 0.2188%
2004	– 0.1714%

Considering the consistent annual decline in the uncollectible rate, DRA recommends the last two-year average be used in for determining uncollectible expense. (Ex. 45, p. 3-13) DRA and San Gabriel have agreed to the use of a two-year average rate of 0.1951%. (Ex. 45, p. 3-13 and Ex. 20, p.24)

San Gabriel's originally proposed uncollectible expense, based on its originally projected 2006-2007 revenues at present rates and its proposed uncollectible factor of 0.2850%, was \$123,600. DRA's recommended uncollectible expense, based on the DRA projected 2006-2007 revenues at present rates and DRA's proposed uncollectible factor of 0.1951%, is \$85,800.

San Gabriel incorporated Franchise Fee Expenses based on a five-year recorded average Franchise Fee rate of 0.8091%. DRA and San Gabriel have agreed that this rate is reasonable. (Ex. 20, p. 24)

VII. GENERAL OFFICE ALLOCATION

The general office allocation consists of common expenses that are not directly assigned to an operating division. These costs are allocated between the Los Angeles Division and the Fontana Division based on a 4-factor allocation formula. Under the

General Rate Case plan, these costs were reviewed as part of the last Los Angeles County division general rate case, A.04-09-005. (Ex. 8 at 18) The amount included in the Test Year 2006-2007 for allocated common costs is \$2,987,800. (Ex. 1 at 11-5) Additionally, \$62,000 is included in Test Year 2006-2007 for bank fees. DRA is not recommending any revisions to the general office allocation.

VIII. TAXES

A. Income Taxes

The difference in income taxes estimated for Test Year 2006-2007 between DRA and San Gabriel are due to the differences in revenues, expenses, and rate base, and San Gabriel's failure to reflect the impacts of the American Jobs Creation Act of 2004 on its income tax expense.

San Gabriel failed to include the impact of the American Jobs Creation Act of 2004, which provides for a deduction equal to 3% of qualified production activities income in 2005 and 2006 and 6% of qualified production activities income in 2007 and 2008. Under the Act, the production of potable water, including the acquisition, collection and storage of raw water, qualifies as a production activity to which the deduction is applicable. As the applicable deduction is 3% for 2006 and 6% for 2007, DRA utilized an average deduction rate for Test Year 2006 – 2007 of 4.5%. In response to a data request (SG-GRC-005, Q5) San Gabriel provided its best internal estimates of the impact of the Act. Based on the response, San Gabriel has estimated the percentage of its net income applicable to production activities to be 51.9%. DRA has reviewed these estimates and finds them reasonable. (Ex. 45, p.6-1) Company witness David Batt agreed that the calculations provided were based on the Company's best estimate of the impact of the Act. (Tr. Vol. 6, p.605, Batt/San Gabriel)

The application of the 51.9% production activities factor to DRA's calculated taxable income at present rates, along with the application of the 4.5% average deduction rate, results in a \$246,100 reduction to taxable income. (Ex. 45, p. 6-3) In flowing through the impact of the 2004 Act, the 51.9% production activities factor should be

applied to the ultimate taxable income for Federal Income Taxes resulting from this case, with the average 4.5% deduction rate then applied to determine the production activities deduction for income tax purposes. This also impacts the net-to-gross multiplier, reducing the effective FIT rate to 34.18%. (Ex. 45, p. 7-2).

San Gabriel disagreed with the application of this adjustment in the rebuttal testimony of David Batt, stating that the Commission should open an OII or OIR to analyze the tax legislation and IRS guidance for ratemaking purposes. (Ex. 19, p.5) In other words, the Company would have the Commission ignore this tax act and ignore the reduction in income taxes that will result until some unknown future date. This is neither reasonable or appropriate. The 2004 Act is already in effect, was in effect for tax year 2005 and beyond, and includes the production of potable water as an item of qualified production income to which the deduction is applied.

Mr. Batt also indicated in his rebuttal testimony that the Commission did not apply the impacts of the 2004 Act in the Company's recent Los Angeles Division rate case, in D.05-07-044, and that it should not deviate from its past precedent. (Ex. 19, p.5) However, Mr. Batt agreed that the Internal Revenue Service has issued further interim guidance on which taxpayers may rely since the hearings in the previous Los Angeles Division rate case. (Tr. Vol. 6, p. 606, Batt/San Gabriel). He also agreed that the IRS has recently published proposed regulations on the implementation of the Act. (Tr. Vol. 6, p.607, Batt/San Gabriel)

DRA calculated tax depreciation for state and federal income tax purposes by applying the ratio of DRA's estimate of net plant to San Gabriel's estimate of net plant to San Gabriel's tax depreciation estimate.

In its report, Exhibit 45, to calculate the interest deduction, DRA used its recommended ratebase, discussed later in this brief, multiplied by DRA's recommended weighted cost of debt of 3.37%. The interest deduction should be determined by applying the weighted cost of debt to the final rate base. The Company has agreed that this is the correct methodology. (Ex. 20 at 17) Since DRA has reached a settlement with

the Company on the capital structure and rate of return, the resulting weighted cost of debt for Test Year 2006-2007 is 3.39% determined based on the average of the 2006 and 2007 weighted cost of debt presented in Joint Exhibit 85. In the Joint Comparison Exhibit, Exhibit 88, DRA's final position reflects the interest deduction based on DRA's recommended rate base and the settled upon weighted cost of debt of 3.39% for Test Year 2006-2007. DRA and San Gabriel are in agreement on the methodology for calculating the interest deduction for income tax purposes and on the weighed cost of debt rate to use. The only remaining difference is with regards to the recommended rate base amounts to which the weighted cost of debt is applied. B. Other Taxes

Taxes Other Than Income include ad valorem tax (property tax) and payroll taxes. San Gabriel included in the 2006-2007 Test Year \$1,034,500 for ad valorem taxes and \$491,800 for payroll taxes. (Ex. 1, p. 7-7) DRA's recommended Test Year 2006-2007 ad valorem taxes are \$766,200 and payroll taxes are \$431,700. (Ex. 45, p. 5-1.)

DRA's ad valorem figure differs from San Gabriel's due to DRA's different rate base estimates, which are discussed later in the next section of this Brief, under IX. Components of Rate Base. Payroll taxes include Social Security tax, Federal Insurance Contribution Act (FICA) tax consisting of Old Age Benefits and Medicare, Federal Unemployment Tax Assessment (FUTA), and State Unemployment Tax Assessment (SUTA).

In projecting payroll tax expense, San Gabriel increased the amount of base payroll subject to Federal and State Unemployment Taxes ("FUTA" and "SUTA") from the actual 2004 and 2005 base of \$7,000 to \$7,300 in 2006 and \$7,600 in 2007. San Gabriel increased the unemployment tax base by approximately its labor escalation rate for each year, rounded. The FUTA and SUTA bases have been at \$7,000 for many years and do not change on an annual basis. DRA recommends the base subject to unemployment taxes remain at the current \$7,000 level. (Ex. 45, p. 5-1) San Gabriel agreed in rebuttal that the FUTA and SUTA tax bases should remain at \$7,000. (Ex. 20, p.17)

In projecting the amount of payroll the Social Security Tax rate for Medicare of 1.45% is applied to, there was an error in San Gabriel's calculations for a Water Quality Specialist at the General Administrative Office on its Workpaper EX1. The error resulted in the tax rate being applied to a salary base that greatly exceeded the projected salary for the position. (Ex. 45, p.5-2). In rebuttal, the Company agreed that this was an error in its calculations. (Ex. 20, p.25)

DRA's recommended Test Year 2006-2007 payroll tax expense is \$431,700, which is \$60,100 less than the amount proposed by San Gabriel. DRA's recommendation flows through the impacts of DRA's recommended adjustments to payroll, reduces the FUTA and SUTA unemployment tax base to \$7,000 for 2006 and 2007, and corrects for the error in the amount of wages subject to the Medicare tax rate. (Ex. 45, p. 5-2)

IX. COMPONENTS OF RATE BASE

A. Current Water Supply System

1. Overview

As described below, the Company's request for plant additions is based on a demand requirement that was determined using the 2004 dry year demand. The supply to meet that demand assumed the worst case scenario in supply availability, including a redundancy factor for mechanical failure and more. By combining the two approaches, the result is an increase in demand matched against a minimum of available supply, which suggests that a significant investment in plant is necessary to provide additional sources to meet the perceived shortfall in supply. The Company's presentation is flawed because it overstated its demand and failed to reflect a proper level of supply that is currently available to them.

The Company's outside consulting engineer, Stephen Johnson, states that "Fontana Water Company is confronted with increased demand throughout its service area as the result of rapid development." The Master Plan for San Gabriel identifies service areas "that will require new sources of water supply, additional storage to provide

operational flexibility and to provide for peak demands and/or fire flow requirements, and new booster plant facilities.” **The Master Plan recommended a Million Gallons per Day (“MGD”) requirement and plant additions based on the 2004 dry year demand (i.e. drought conditions)**(emphasis added). (Ex. 45, p. 8-5) The Company’s witness Mr. Johnson acknowledged that the supply requirement in the Master Plan is based on drought conditions. (Tr. Vol. 2, p. 98, Johnson/San Gabriel) Mr. Frank LoGuidice, Vice President of Engineering, indicated that the 2004 drought was the worst drought in the last 100 years or so. (Tr. Vol. 2, p. 144/145, LoGuidice/San Gabriel)

Mr. LoGuidice's testimony states that “Additional sources of water supply are required to keep pace with the growing demand and the loss of supply due to contamination and the lasting effects of the recent drought.” Mr. LoGuidice continues his discussion by contending that it is vital that San Gabriel have sufficient water supply, and to meet these requirements, it plans to construct eight new wells over the next four years. Five of the wells proposed are at new or planned plant sites, and one well planned for an existing plant site would require the acquisition of land to accommodate the well(s). The remaining two wells are proposed for existing plant sites. (Ex. 45, p. 8-5/6)

One of the Company’s supply needs includes a proposed upgrade and expansion of the Sandhill Treatment Facility. The existing Sandhill Treatment Plant has a rated capacity of 20 MGD, but backwash operations reduce the plant’s capacity to 17 MGD. Overall production has been limited by water supply and water quality. (GRC-005-6) Limitations have been imposed as a result of the high level of turbidity. (Ex. 45, p.8-6) Additionally, Mr. LoGuidice stated the Sandhill Plant is not designed to meet peak summer demands. (Tr. Vol. 3, p. 207, LoGuidice/San Gabriel) Mr. LoGuidice stated that “you cannot rely upon water from the State water project to be available every summer, day in and day out” and that the Company made the assumption as if that plant was not available. (Tr. Vol. 3, p.204)

Mr. McGraw, however, stated that the Company contemplates using the Sandhill Plant “on a reliable and continuous basis, based on the water sources that are going to be

utilized at the plant, whether it be State project water or Lytle Creek surface water”. (Tr. Vol. 3, p. 267, McGraw/San Gabriel) Mr. Johnson stated that he certainly would not rule out the State water project providing water during the peak periods in the summertime. (Tr. Vol. 2, p. 47/48, Johnson/San Gabriel)

Purchased water is the remaining source of supply for the Company. According to San Gabriel workpaper RV2, the amount of purchases has increased from 1,407 Acre Feet per Year (“AFY”) in 2002 to 2,878 AFY in 2004. The projected supply requirements forecast minimal purchases. (Ex. 45, p.8-6/7) Mr. LoGuidice, however, indicated that the Company has met its demand requirements the last four or five years. The Company struggled at times, but they met the requirement by purchasing water from a neighboring water agency. (Tr. Vol. 3, p. 219, LoGuidice/San Gabriel)

San Gabriel workpaper RV2 indicates that its supply requirement will be 46,837 AFY in 2005, 47,838 AFY in Test Year 2006-2007, 48,978 AFY in escalation year 2007-2008, and 50,118 AFY in escalation year 2008-2009. Table 3-32 of the Master Plan was identified by the Company as being the source for the system requirements. The requirements were based on the projected peak day demand. The 2005 projected peak day demand of 73.8 MGD is equivalent to 82,864 AFY, which is 76.9% more than the Company’s projected supply requirement of 46,837 AFY for 2005. (Ex. 45, p.8-7)

Mr. Johnson stated that the Master Plan recommends redundant well capacity for at least 32,000 Gallons per Minute (“GPM ”). That equates to 8.6 MGD for mechanical failure and more. (Tr. Vol. 2, p. 76/77, Johnson/San Gabriel) The maximum day demand in 2005 was 66 MGD. (Tr. Vol. 2, p. 86, Johnson/San Gabriel) And Company witness Mr. Johnson believes the peak demand in 2004 was the same 66MGD level that occurred in 2005. (Tr. Vol. 2, p.95, Johnson/San Gabriel) Mr. Johnson acknowledged that the forecast in the Master Plan for future years used similar data to that used to predict 2005. He also acknowledged that to the extent the 2005 was in error, the same error could exist for the remaining calculations. (Tr. Vol. 2, p. 36, Johnson/San Gabriel)

The Company’s request for additions to plant appears to be structured on the Company’s need to meet its peak day demand. While the Company must have sufficient

resources to meet its peak day requirements, it is not appropriate for ratepayers to fund facilities to produce that requirement on a daily basis. A system that produces the peak day demand would have excess capacity that is not used and useful to ratepayers over the rate period. Alternative sources of supply, such as the outside purchases and emergency purchases relied on in the past, should be incorporated in the Company's forecast.

(Ex. 45, p.8-7)

When referred to the demand discussion in Exhibit 45, page 8-7, DRA witness Schultz indicated that DRA's main point is that the Master Plan recommended a MGD requirement and plant additions based upon the 2004 dry year demand, which were drought conditions. Mr. Schultz indicated that the Company took the worst-case scenario and used that as a basis for generating the supply requirements. A worst case scenario should not be the only fact to consider. Mr. Schultz observed that the peak day demands are significant in comparison to the annual requirements. It is not appropriate for a utility to determine demand on the worst day ever under drought conditions and then only rely on certain facilities operating and not on others in determining whether additional plant is needed. (Tr.Vol.4, p.379/380, Schultz/DRA) DRA recommends that if drought conditions are used for demand requirements, wells that were used to meet those peak day demand requirements must be considered, along with alternative sources of supply, such as the outside purchases and emergency purchases relied on in the past.

The Master Plan Table 5-5 (Ex. 13) reflects production facilities available and unavailable based on information from the Company. (Tr. Vol. 2, p. 29/30, Johnson/San Gabriel) The Master Plan, Table 5-5 assumes available well capacity of 59.0 MGD. (Ex. 13, p.128) And Exhibit 31 shows the July 20, 2005 maximum day demand of 66 MGD was met with the wells producing 58.8 MGD.

Additionally, while reviewing Exhibit 31, Witness Johnson acknowledged that on July 20, 2005, the peak demand was met using wells F29A, F34A, F36 and F40, which were wells that he assumed were unavailable in Exhibit 13 (The Master Plan) on April 11, 2005. Mr. Johnson also acknowledged that wells F17B and F17C could provide

potable water supply if the treatment facility is operating. The F17 wells were not reflected as available sources in either Exhibit 13, Table 5-5 or to meet the peak demand on July 20, 2005 as Exhibit 31 indicates. (Tr. Vol. 2, p.30/33, Johnson/San Gabriel) Further, Mr. LoGuidice indicated that wells F17B and F17C can be considered a viable source because they are expected in service shortly. (Tr. Vol. 2, p. 148/149, LoGuidice/San Gabriel) The wells at F17B and F17C could provide 7.2 MGD of supply. (Tr. Vol. 2, p. 80, Johnson/San Gabriel)

Mr. LoGuidice stated that San Gabriel added a well at F7 since the drought, (Tr. Vol. 2, p. 146, LoGuidice/San Gabriel) but well F7B is not listed or considered as an available source of supply in either Exhibit 13 (The Master Plan) or on Exhibit 31 as a source in meeting the July 20, 2005 peak demand.

Exhibit 37 shows well production equal to 87.82 million gallons a day. Mr. LoGuidice agreed that all the wells on Exhibit 37 were for the most part able to provide water at the capacity listed. Wells F17B and F17C are currently out of service, but will be in service in a few months. One of the Lytle Creek wells is still out of service. (Tr. Vol. 3, p. 181, LoGuidice/San Gabriel)

The Company introduced Exhibit 41, which showed a comparison of Exhibit 37 capacity and capacity based on a ten-year average. Exhibit 41 reflected a total capacity of 75.66 MGD compared to the 87.83 MGD shown on Exhibit 37.

Mr. LoGuidice explained the purpose of the Exhibit 41 was the important information stated in the columns, which included the Chino Basin and Unnamed Basin wells and how it identifies 45.8 MGD of total reliable supply. The other two columns, state the Colton/Rialto Basin and the Lytle Creek Basin were unreliable supplies. Mr. LoGuidice further stated that production from the Colton/Rialto Basin was curtailed in 2004 and 2005 and that they cannot be relied upon during summers to be a source of water. (Tr. Vol. 3, p. 169/170, LoGuidice/San Gabriel) However, the City of Fontana's witness, Mr. Bierschbach stated that "The Colton/Rialto Basin has never been unreliable

in the last hundred years as far as water supply.” (Tr. Vol. 5, p. 419, Bierschbach/City of Fontana)

Mr. LoGuidice indicated that the Company lost the use of 6 wells in the Lytle Creek Basin and 4 wells in the Colton/Rialto Basin during the drought. The loss was not permanent and all but one in the Lytle Creek Basin are back in service. (Tr. Vol.3, p. 216/217, LoGuidice/San Gabriel) It should also be noted that there are 11 wells in the Lytle Creek Basin. Thus, not all the wells were temporarily out of service. Additionally, the winter of 2004-2005 was the second wettest in LA history, and thus the aquifers have now been recharged.

Attachment 5 to Mr. LoGuidice’s rebuttal testimony is the response to City Request 3-1. That response identifies the sources of supply to meet the maximum day demand on August 11, 2004 (the drought year). The response shows that all four of the unreliable Colton/Rialto Basin wells were a source of supply to meet that summer day demand. The response shows that seven of the 11 unreliable Lytle Creek Basin wells were a source of supply to meet that summer day demand. (Ex. 21)

Exhibit 31 shows that on July 20, 2005, 2 of the four Colton/Rialto Basin wells and eight of the 11 Lytle Creek Basin wells were a source of supply to meet that summer peak day demand. The wells, however, were those that Company Exhibit 41 identified as unreliable.

The Company’s analysis provided in the response to GRC-003-67 reflects a deficiency because the supply forecast reflects 16 wells out of service, ten of which are for mechanical failures. San Gabriel’s projection appears to be a worst case scenario in available supply because the production supply using current availability and the addition of F7 is more than sufficient to meet the projected short term needs. (Ex. 45, p. 8-8) For instance, the well at Plant F7 will produce approximately 2000 GPM. (Ex. 9, p.23) That equals approximately 2.9 MGD. Mr. LoGuidice indicated the information in the response to GRC-003-67 was an estimate done in August 2005, based on the Master Plan and was

not corrected for actual data or the Lytle Creek wells being in service. (Tr. Vol. 3, p. 200/201, LoGuidice/San Gabriel) In addition, the Company supply requirements as reflected in the Master Plan and San Gabriel's filing do not consider the availability of recycled water or the potential impact of conservation efforts. (Ex. 45, p.8-7)

The proposed upgrade to the Sandhill Plant would increase the supply from the 5-year historical average of 4,085 AFY to 22,456 AFY when producing at 20 MGD, or 32,562 AFY if producing at the optimum of 29 MGD. When adding the optimum well production of 69,480 AFY and the supply from the treatment facility of 20 MGD (22,456 AFY) surface water, the result is 91,936 AFY at the end of 2007 which exceeds the San Gabriel peak demand requirement for 2007 of 77.1 MGD or 86,569 AFY as shown in the Company's response to GRC-006-67. (Ex. 45, p. 8-8)

The Company's Master Plan estimated a peak demand requirement of 73.8 MGD, which as discussed above was well in excess of the 2005 peak demand of 66 MGD. Based on the Master Plan, the available supply from wells was 59MGD, which did not add the wells back in service listed on Exhibit 39 and that also increased supply by 17.4MGD. And by adding the estimated supply of 2.9 MGD for the well at F7, which DRA recommends be allowed in this proceeding, the total supply from wells alone is approximately 79.3 MGD. This supply from wells does not include the supply from Lytle Creek flow or purchases. The supply exceeds the overstated requirement of 73.8 MGD by 5.5 MGD. The Company's supply is sufficient to meet its requirements at this time. Thus, 7 of the 8 additional wells requested and the upgrade to the Sandhill Plant are currently not required.

2. Water System Master Plan

The Company's outside consulting engineer, Stephen Johnson, states that "Fontana Water Company is confronted with increased demand throughout its service area as the result of rapid development." In the Master Plan for San Gabriel, Mr. Johnson identified service areas "that will require new sources of water supply, additional storage

to provide operational flexibility and to provide for peak demands and/or fire flow requirements, and new booster plant facilities.”

The Master Plan identified needs and requirements under different scenarios and provided a detailed pictorial tour of the Company facilities, along with condition assessments of the existing plant facilities. The Master Plan, however, recommended the MGD requirement and plant additions based on the 2004 dry year demand (i.e. drought conditions). (Ex. 45, p. 8-5) The Company’s witness Mr. Johnson acknowledged that the supply requirement in the Master Plan is based on drought conditions. (Tr. Vol. 2, p. 98, Johnson/San Gabriel) The Master Plan Table 5-5 (Ex. 13) reflects production facilities available and unavailable based on information from the Company. (Tr. Vol. 2, p. 29/30, Johnson/San Gabriel) The Master Plan, Table 5-5 assumes available well capacity of 59.0 MGD. (Ex. 13, p.128)

Mr. Johnson stated that the Master Plan recommends redundant well capacity for at least 32,000 GPM, which equates to 8.6 MGD for mechanical failure and more. (Tr. Vol. 2, p. 7, Johnson/San Gabriel) Mr. Johnson acknowledged that the forecast in the Master Plan for future years used similar data to that used to predict 2005. He also stated that to the extent the 2005 was in error the same error could exist for the remaining calculations. (Tr. Vol. 2, p. 36, Johnson/San Gabriel)

B. Plant Additions

1. Sandhill Surface Water Treatment Plant

a) History and Description of the Sandhill Project

Overall production for the Sandhill Project has been limited by water supply and water quality. (GRC-005-6) Mr. Black discussed limitations imposed as a result of the high level of turbidity. As shown in Attachment A to DRA’s Direct Testimony, the Sandhill Treatment Plant has operated at 50% or less capacity for 79.53% of the time over the last 10 years. Over the last 5 years, the plant has operated at 50% or less capacity for 90.59% of the time. Thus, the existing facility, absent modifications, has very limited capacity. (Ex. 45, p.8-6)

The Company's proposed modifications include the construction of pre-treatment facilities capable of treating up to 20 MGD. During periods of high turbidity, the facility will be able to treat up to 20 MGD. When water is less turbid, an additional 9 MGD will be treated directly through the existing Sandhill plant filters for a total output of 29 MGD. (GRC-005-6)

The upgrade essentially provides for an additional 12 MGD treatment by three new filters and 8 MGD of treatment by the existing facility filters during high turbidity. During periods when the water is less turbid, the plant remaining will generate the 9 MGD capacity from the existing facility. (i.e. 8 MGD + 9 MGD= 17 MGD) In essence, the modifications and upgrade to the Sandhill Treatment Plant will make it possible to operate the existing facility at 17 MGD during less turbid periods and add 12 MGD of new treatment. (Ex. 45, p.8-6)

The sources of supply for the Sandhill Plant are from the State water project and water from Lytle Creek. (Tr. Vol. 3, p. 182, LoGuidice/San Gabriel) The Company indicated that the State water project water is from two sources. One source is the San Bernardino Valley Municipal Water District at a cost of \$125 per acre foot up to 5,000 acre feet per year. This supply is available during the summer months at 6,000 gallons per minute (i.e. 8.6MGD). The other source is the Inland Empire Utilities Association of approximately 28 MGD. (Tr. Vol. 3, p. 184/185, LoGuidice/San Gabriel)

b) Evaluation of Need and Cost Effectiveness

The Company is requesting the cost of the Sandhill Plant upgrade be reflected in rates in part as part of rate base (\$12 million) and the remainder through Advice Letter treatment. The upgrade is needed (according to Company testimony) to provide additional supply for current and future customers. DRA is concerned that the in-service date, the cost and the available supply is not known and measurable and the need has not been established.

The original in-service date was November 2006, then January 2007 and now August 2007. The cost in A.02-11-044 was \$9.8 million, but in this proceeding the

Company is requesting \$38 million while the Master Plan indicates the cost could ultimately be \$77.8 million. As described above in the supply discussion, the Company's witnesses do not agree whether the supply can be relied on in the summer to meet peak demands and there are no formal contractual commitments for providing additional supply. Supply exists to meet the average requirements and if the Sandhill Plant cannot provide supply to meet peak demands, there is insufficient justification to allow the addition in rates. DRA recommends the Advice Letter treatment should be denied and the cost and used and usefulness of the plant determination be deferred until the next GRC.

The Company states that the upgrades and modifications to the Sandhill Plant are needed to meet the current and foreseeable water supply requirements for Fontana Water Company's customers. (Ex. 7, p. 13) Construction is to be completed in November 2006 and the estimated cost is \$33.57 million plus approximately \$1 million for engineering services. (Ex. 7, p. 16)

It is uncertain, however, when the exact start-up date is San Gabriel witness Daniel Dell'Osa states in his discussion regarding the cost benefit of the Sandhill Treatment Plant, that the plant start-up date is January 2007, but the response to Data Request GRC-010-01 indicates that the start-up date is now August of 2007. The plant is not used and useful in 2005, won't be used and useful in 2006, and may possibly only be used and useful in late 2007, which is after the Test Year 2006-2007. (Ex. 45, p. 8-16)

In A.02-11-044, San Gabriel requested that it be allowed to upgrade the Sandhill Treatment Plant at an estimated cost of \$9.8 million. A January 2004 report for the design of a 20 MGD conventional water treatment plant at the Sandhill Plant site estimated the cost to be \$18.75 million. Somehow in two years, the cost has escalated to \$34 million, a phenomenal increase in a time of low inflation. In GRC-011-9, DRA requested the Company provide an explanation for the cost difference between the original \$9.8 million and the current \$34 million. San Gabriel ultimately provided a response, but again was not very descriptive of the cost escalation. Thus, San Gabriel has

not justified the significant projected increase in costs from the prior estimates. (Ex. 45, p. 8-16)

Mr. Chris Diggs indicated that he did adopt Mr. Black's testimony that stated that the Sandhill Plant upgrade was already approved in rates and the Company was not asking for approval of this project again. Mr. Diggs indicated that the cost was \$9.8 million in the prior rate case and the cost is now \$35 million because it is not the same project. Mr. Diggs was not aware of whether the Commission approved the change. (Tr. Vol. 2, p. 134/135, Diggs/San Gabriel)

Mr. LoGuidice when asked about the cost in the Master Plan agreed that \$77.8 million was the cost in the Master Plan if all costs were added. Mr. LoGuidice stated that the amount in the Master Plan not only includes the \$34 million the Company intends to expend for modifications now and the \$4 million for pipelines, but it also includes dollars for facilities that may or may not be necessary in the future. (Tr. Vol. 3, p. 232/233, LoGuidice/San Gabriel)

Despite these increased costs for the Sandhill Plant, the Company failed in many respects to properly evaluate this project. Mr. Johnson stated he had not done an evaluation on whether there might be a more cost-effective way of achieving the same goals of the proposed upgrades for the Sandhill Plant. (Tr. Vol. 2, p.89/90, Johnson/San Gabriel) Additionally, the Company's engineering department did not do a cost benefit analysis for the Sandhill Plant modifications. (Tr. Vol. 3, p. 226, LoGuidice/San Gabriel)

Mr. Dell'Osa, in fact indicated that he prepared a cost-benefit analysis in May 2005 and submitted that analysis with the proposed application in June 2005. Mr. Dell'Osa acknowledged that the cost-benefit analysis was performed after the construction contracts were signed. (Tr. Vol. 4, p. 331, Dell'Osa/San Gabriel) Mr. Dell'Osa also indicated that he did not verify the assumptions, and he agreed that the study is only as good as the assumptions are. (Tr. Vol. 4, p. 333/334, Dell'Osa/San Gabriel) Lastly, Mr. Dell'Osa indicated that in preparing the cost-benefit analysis, no

other alternatives were considered other than the additional wells in the Chino Basin (Tr. Vol. 4, p. 333/334, Dell'Osa/San Gabriel)

During the summer time, Lytle Creek flow decreases and any increase in demand from the expansion of Sandhill would have to come from the State water project. Typically summer time Lytle Creek flow is well below the current 17 million gallon per day capacity. Thus, to meet peak demand, the Company must purchase water from the State water project. (Tr. Vol. 3, p. 183, LoGuidice/San Gabriel)

Mr. LoGuidice in fact stated the Sandhill Plant is not designed to meet peak summer demands. (Tr. Vol. 3, p. 207, LoGuidice/San Gabriel) He stated that "you cannot rely upon water from the State water project to be available every summer, day in and day out" and that the Company made the assumption that the plant was not available. (Tr. Vol. 3, p.204) He added that the Company did not have a contract in place for State project water for the Sandhill Plant. And the Inland Empire Utilities Agency assured San Gabriel that water will be available in quantities sufficient to meet San Gabriel's needs. However, this assurance was oral. (Tr. Vol. 3, p. 211/212, LoGuidice/San Gabriel)

DRA's primary concern with San Gabriel's proposed Sandhill Treatment Plant upgrade is that San Gabriel has reflected \$12 million of the estimated \$34 million cost in plant in service and is proposing to collect the remaining \$22 million of the estimated cost through Advice Letters. The Company believes that the use of Advice Letters is justified because the timing and/or cost of the project is difficult to forecast with reasonable certainty. The Company's proposal for Advice Letter treatment would include adding interest during construction (IDC) to the cost being included in rates. The lack of precision in San Gabriel's cost estimates and the unknown quantity of interest expenses are of concern to DRA, along with the uncertainty of the ultimate amount of additional supply that will result from the upgrade. (Ex. 45, p.8-15/16)

As an alternative, DRA recommends that the projected \$12,000,000 of cost in 2005 be removed from plant. The plant upgrade will not be in service in 2005. The November 14, 2005 response to Field Visit Request (10/25/05 to 10/27/05) indicated the

cost incurred to date was only \$4 million. DRA recommends the cost be excluded from plant in this rate case and that the Company not be allowed to recover the cost through an Advice Letter. The next GRC is the proper time to make a determination as to whether the final cost is appropriate and to determine the actual increase in capacity that will occur as a result of the upgrade. (Ex. 45, p. 8-16)

The significant cost associated with the project and the fact that some uncertainty remains about the amount of surface water that will ultimately be treated at the site, warrants that the final determination be deferred until a future date. The Company plans to accumulate charges for Interest During Construction (“IDC”) in the cost. Thus this will protect the Company’s investment until such time a final determination can be made. Ratepayers should also be protected by deferring the cost to the next GRC. The deferral of the cost would serve as notice to shareholders that the full cost of the facility will be reviewed upon completion for reasonableness, and a determination can be made whether the upgrade is used and useful. (Ex. 45, p. 8-16/17)

2. Wells

The Company’s request to add eight wells is based on the perceived need for additional supply. The supply discussion above sufficiently explains why the Company’s request is not justified. DRA’s recommendation to allow the cost of the well at F7 is supported by the evidence as explained in the supply discussion.

The Company is proposing to add eight (8) wells over the next four years. The well at site F7 proposed for 2005 has been constructed. There are three wells proposed for site F51 in 2006, a well is proposed for site F21 in 2007, one well at F37 and two wells are proposed for the planned site F54. Land has been acquired for the site F51 well and is included in plant in service. Land has not been acquired for the site F21 or the site F54 wells. (Ex. 45, p.8-7) and (Tr. Vol. 4, p.364, Schultz/DRA)

In A.02-11-044, the Company requested and was allowed the three wells at Plant F51 in Test Year 2003. These wells were not put in service as projected in 2003 and are again being requested in this case. According to the Master Plan (p. 98), the water

demands under normal weather conditions are estimated to be 54,000 AFY in the short-term (2010), and with a water conservation program, demand is estimated to be 51,300 AFY in the short term. As shown on Attachment B, attached to DRA's Direct Testimony, the production available as of April 11, 2005 was 59.0 MGD or 66,246 AFY. (Ex. 45, p.8-8)

The addition of the well at F7 in 2005 increases the production available by 2.9 MGD or 3,234 AFY for a combined production availability of 69,480 AFY. This does not factor in the added availability that could result from any allowance for treatment facilities that would allow inactive wells to become active. The current system has sufficient supply to meet and even exceed the projected short-term needs of 54,000AFY without the added supply from surface water and emergency purchases. (Ex. 45, p.8-8)

DRA recommends that only the F7 well be allowed in rates at this time. The removal of the seven wells reduces plant by \$700,000 in Test Year 2006-2007, and \$700,000 in Escalation Year 2007-2008. (Ex. 45, p. 8-8/9)

3. Wellhead Treatment Facilities

The Company has proposed to add \$12,010,000 in 2005, \$10,000 in 2007 and \$2,010,000 in 2008 for treatment equipment and structures. The proposed cost is primarily \$12,000,000 of additions to the Sandhill Treatment Plant in 2005 and \$2,000,000 in 2008 for the ION exchange facility at F25.

Based on the above recommended disallowances for wells and/or reservoirs (discussed later), the associated 2007 Plant F51 costs should be reduced \$10,000 and the associated plant F54 costs in 2008 should be reduced \$10,000. (Ex. 45, p. 8-15)

DRA is concerned that the Company's requested addition in 2008 of the ION exchange facility, ignores the fact that the cost of the facility should be borne by the parties responsible for the contamination at F25. In A.02-11-044, San Gabriel contended that it could not put on hold the construction of treatment plants while waiting for litigation proceeds because it urgently needed the restoration of lost production capacity.

The Commission approved the Company's request for seven facilities in the prior case, but no facilities, however, were constructed. DRA submits that San Gabriel's conception of urgency varies from the ordinary sense of the word. How can the Commission be confident it will actually build the facility in 2008 when it failed to do it over the past three years despite the alleged exigency of restoring this source of supply? Plant F25 is now being requested again and is now projected to be constructed in 2008. The urgency, however, for Plant F25 appears to subside at times and reappear later. San Gabriel has not explained the reason for this occurrence. (Ex. 45, p.8-17)

Mr. Johnson indicated that the perchlorate facility proposed at F25 is for the wells at F18 and F35. F18 was installed in 1951 and has a calculated remaining life of 8 years. F35 was installed in 1918 and has an estimated remaining life of 4 years. (Tr. Vol. 2, p. 58/61, Johnson/San Gabriel) DRA is concerned that the remaining life of the wells does not justify the proposed cost of the treatment facility.

DRA recommends the \$2,000,000 of cost for the Ion Exchange Facility be removed from plant additions because it is not known and measurable, and the cost is projected far enough into the future that some determination should be made regarding the responsible parties' obligations by that time. The cost of this project instead should be reflected as contributed plant if the plant is ultimately constructed. (Ex. 45, p. 8-17)

4. Reservoirs

The Company is requesting a total of nine reservoirs. The filing reflects eight added in company-funded plant and one in plant advances. The Company stated its concern is insufficient storage within specific zones and affording an opportunity for the cleaning of reservoirs. The proposed additions include three reservoirs that are either constructed or under construction (two at F48 and one at F7). DRA recommends that the combined request for reservoirs at F15 and F16 be limited to a single reservoir since the pressure zone to be served is F19, which already has a 6.19 gallon surplus and that surplus will also be increased by the two reservoirs at F48.

DRA recommends the reservoir requested for F37, F51 and F54 not be allowed in rates. The reservoir at F37 would serve the Juniper zone, which has a 5.11 million gallon surplus. The reservoir at F51 was requested and allowed in A. 02-11-044 because of its "perceived" need, but the Company did not construct it in 2003 as they indicated. Apparently, the "perceived" need disappeared. And the proposed reservoir for F54 does not have a site to construct the facility, which suggests the request is premature. DRA's Table 8-1 reflects a reduction to plant for reservoirs of \$727,500 in 2006/2007 and a reduction to plant of \$1,527,000 in 2007/2008.

San Gabriel's filing states that it is requesting that eight reservoirs be added to plant in service from 2005-2008. The filing, however, really reflects nine reservoirs. In 2005, San Gabriel proposes to add a 1.5 million gallon reservoir at plant F7 to improve its ability to reliably meet customer demands in the area, particularly in the Baseline pressure zone, to enhance operational flexibility, and to allow for enhanced disinfection prior to pumping the water into the distribution system. Construction is underway for this facility. (Ex. 45, p. 8-9/10) Mr. Johnson indicated the Baseline pressure zone has a storage deficiency of 3.78 million gallons. (Tr. Vol. 2, p. 63, Johnson/San Gabriel)

In 2005, San Gabriel also proposes to add two reservoirs at plant F48. The proposed reservoirs at F48 are not discussed in detail in the filing and have actually been constructed at site F48. The 700,000 gallon reservoir, which is not counted by the Company, is listed in plant advances and the 300,000 gallon reservoir is listed under company-funded plant. (Ex. 45, p. 8-10) Mr. Johnson indicated that the reservoirs at F48 would serve the F-19 pressure zone. (Tr. Vol. 2, p. 66, Johnson/San Gabriel) And Mr. Johnson indicated the F-19 pressure zone has a storage surplus of 6.19 million gallons. (Tr. Vol. 2, p. 63/64, Johnson/San Gabriel)

In 2007, San Gabriel proposes to add a 2.5 million gallon reservoir at F15, a 1.5 million gallon reservoir at F16, and a 1 million gallon reservoir at F51. The F51 reservoir originally budgeted for in 2003, was not completed because San Gabriel claims it was limited by the last rate order to a 10% increase per year in plant additions. In 2008, San

Gabriel requests adding a 1.5 million gallon reservoir at F37, a 1 million gallon reservoir at F44, and a 1 million gallon reservoir at F54. (Ex. 45, p. 8-10)

Mr. Johnson indicated that reservoirs at F15 and F16 would serve the F-19 pressure zone, the F44 and F51 reservoirs would serve the Highland and Alder pressure zones, and the F37 reservoir would serve the Juniper and Baseline pressure zones. (Tr. Vol. 2, p. 65/67, Johnson/San Gabriel)

Mr. Johnson also stated the F-19 pressure zone has a storage surplus of 6.19 million gallons, Highland zone has a .25 million gallon deficiency, the Alder zone has a .36 million gallon surplus, the Juniper zone has a 5.11 million gallon surplus and the Baseline zone has a 3.78 million gallon deficiency. (Tr. Vol. 2, p. 63/64, Johnson/San Gabriel) Mr. Johnson identified a proposed site for F-54 and indicated that the site would be in the F19 zone, but would serve the Baseline, Highland and F19 zones. (Tr. Vol. 2, p.99, Johnson/San Gabriel)

According to the Company's Master Plan, it currently has 30.28 million gallons of useable storage capacity. (Company Exhibit SG-13; Table 7-3) Based on the requirements for equalization, fire suppression and emergency, the Company total storage requirement is 22.65 million gallons. By the year 2010 and 2025, the projected requirement is expected to be 24.81 million gallons and 31.12 million gallons, respectively. The current existing capacity exceeds the current and short-term needs of the Company and is approximately 1 million gallons short of the long-term requirements. The Company is requesting the addition of the nine reservoirs to meet its requirements by pressure zone. (Ex. 45, p. 8-10)

Company Exhibit SG-13, Table 7-6, indicates that the current storage deficiencies are 3.78 million gallons in the Baseline Zone and .25 million gallons in the Highland Zone. In an interview, Mr. Johnson stated that in assessing the pressure zone shortages and surpluses, the consultants did not verify whether water could be moved from zone to zone to compensate or offset the deficit zones with the surplus zones. The nine added reservoirs would add a total 11 million gallons of storage, but this is not useable storage.

Mr. Johnson acknowledged that San Gabriel did not conduct a written study that shows whether surplus storage in some zones can be used to offset deficiencies in other zones. (Tr. Vol. 2, p.94) The proposed additions could still leave the Baseline Zone deficient in the short-term (2010) and would increase the surplus in the F-19 Zone. While the F-16 addition is in the “so-called” deficient Highland Zone, the justification for the reservoir is that it is the primary source of supply for F-15, which is in the F-19 pressure zone that currently has a 6.19 million gallon surplus. While site F54 is proposed for the deficient Baseline Zone, the site has not yet been established and is speculative at this time. (Ex. 45, p. 8-11)

San Gabriel claims that there is a need for the additional reservoirs so proper maintenance can be completed on existing reservoirs that cannot be taken out of service otherwise. In response to MDR IV.D.2, San Gabriel provided its 2001 Annual Inspection Report. On page 7 of the report (P. 375 of MDR), it states “All reservoirs are drained and inspected about every two years.” That statement suggests that the Company’s claim that it cannot take a reservoir out of service is inaccurate. Of the nine added reservoirs, six are at new site locations and only three are for secondary facilities. (Ex. 45, p. 8-11)

DRA recommends the reservoirs constructed or under construction in 2005 be allowed in rates. The addition at F7 will help alleviate concerns with the deficiency in the Baseline Zone, and the two F48 reservoirs are needed to serve the customer growth at Hunters Ridge. DRA, however, recommends that the \$340,000 for the 300,000 gallon reservoir at F48 be removed from Company-funded plant and included in plant contributions with an offsetting credit in CIAC. The Hunters Ridge development is the reason why the reservoir was constructed on the mountain, and absent any documented study that shows otherwise, the cost of the reservoir should be contributed by the developer. (Ex. 45, p. 8-11/12)

In 2007, San Gabriel requests that additional reservoirs be built at F15 and F16 to provide a reliable supply for Hunters Ridge. DRA is concerned about the \$3 million cost of the reservoirs, booster pumps and emergency generators at these two plants. According to Company testimony, the facilities are required to provide an extra level of

reliability to a specific group of customers. In response to data request GRC-006-4, San Gabriel stated the addition is required because the current reservoir at F15 “provides virtually all of the water supply” to more than 11,400 customers in the F19 Pressure Zone.

Another concern with the Company’s request for additions to both plant F15 and F16 is that the facilities are in close proximity to the Sierra Lakes area that has been identified as the “Future Possible Development Area During Next Five Years” on Figure 7-4 of the Master Plan. DRA believes that the addition of the requested reservoirs and other facilities is excessive and could be related to future growth. To the extent that any addition to plant is growth-related, the cost of the added facilities to serve that growth should be contributed by the developer. (Ex. 45, p. 8-12) DRA, recognizes that some justification exists for additional facilities within the area and recommends that half of the combined cost for F15 and F16 be allowed. The location(s) and the size of the reservoir(s) should be left to the discretion of the Company to determine the most functional alternative. (Ex. 45, p. 8-12)

San Gabriel is requesting that a reservoir be constructed at site F51 along with other facilities in 2007 and at F44 in 2008. The Company testimony simply states that the facility at F51 is needed due to lack of sufficient storage and production capabilities in the area. San Gabriel requested the reservoir for F51 in A.02-11-044 be allowed in rates based on the Company’s plan to construct the facility in 2003. The facility, however, was not constructed and now is being requested to be put in rates a second time. (Ex. 45, p. 8-12/13)

The Company decided not to construct the reservoir in 2003. The fact that the Company was allowed the plant in A.02-11-044 and it was not constructed shows that projected plant projects requested are not necessarily required as the Company claims. For example, the additions at F44 would improve the operations at F44 because it would allow for the three existing wells to address any added demand requirements and allow for more flexibility. DRA in Data Request GRC-009-12 requested San Gabriel to

provide historical statistics that show due to growth and/or changes in consumption that similar facilities are required for F44 and F51.

The response did not provide any statistics and instead relied on the pressure zone shortage identified in the Master Plan as its justification for the reservoirs at F44 and F51. San Gabriel's testimony and responses to discovery do not provide sufficient justification for adding both of the requested reservoirs. DRA recommends the reservoir at F44 be allowed to help address the needs of the perceived shortage in the Highland pressure zone and create flexibility in meeting current and future demand needs. The cost for the reservoir at Plant F51 has not been justified for a second time and should be disallowed. (Ex. 45, p. 8-13) Indeed, San Gabriel's unwillingness to construct facilities that it contended were needed in earlier applications brings the accuracy of its entire capital program into question.

In 2008, San Gabriel proposes to add new reservoirs at F37 and F54. The Company has indicated that the purpose of the reservoir at F37 is to improve the disinfection process of water produced on-site and increase the amount of storage that will service the Juniper pressure zone. Company Exhibit SG-13, Table 7-6, indicates that the Juniper Pressure Zone already has a significant storage surplus. Justification for the F37 reservoir is not sufficient. (Ex. 45, p. 8-13)

The proposed addition at site F54 is planned to accommodate growth and reduce pressure in the Alder Pressure Zone and provide adequate pressure in the Baseline Pressure Zone. The land for F54 has not been acquired, the site has not yet been definitely determined, and the need is based on future growth. When and/or if that growth occurs, at that time, the customers that will be served should be required to pay for the plant. The additions at F37 and F54 are not justified and DRA recommends they be removed from the Company's request.

DRA's recommendation to allow a reservoir at Plant F7, two reservoirs at Plant F48, a reservoir for either F15 or F16 and a reservoir at Plant F37 would increase the

current storage surplus by approximately five million gallons, and it would help alleviate the pressure concerns in the Baseline pressure zone.

5. Booster Stations

The Company plans to construct a booster station at Plant F7 consisting of six booster pumps, which can pump into two different pressure systems from this location. (Ex.9, p. 24) DRA recommends that F7 be allowed in rates. (Ex. 45, p. 8-8)

The Company plans to construct a booster station at F16 along with a reservoir and emergency generator. (Ex. 9, p.26) DRA is concerned with the request for additions to both Plant F15 and F16 because the facilities are in close proximity to the Sierra Lakes area that has been identified as the “Future Possible Development Area During Next Five Years” on Figure 7-4 of the Master Plan. It believes the addition of the requested facilities is excessive and could be related to future growth. DRA does recognize that some justification exists for added facilities and recommends that half of the combined costs for booster stations at F15 and F16 be allowed. (Ex. 45, p.8-12)

The Company plans to construct a booster station at Plant F37 consisting of six booster pumps which can pump into two different pressure systems from the reservoir at this location. (Ex.9, p. 29) The purpose of the reservoir at F37 is to improve the disinfection process of water produced on-site and increase the amount of storage that will serve the Juniper pressure zone. According to Table 7-6 in Exhibit 13, the Juniper pressure zone already has a significant storage surplus. The additions at F37 are not justified and DRA has removed them from the Company’s request. (Ex. 45, p. 8-13/14)

The Company requests that three wells, a million gallon reservoir and booster station be added at Plant F51 due to the lack of sufficient storage capacity and production capability in the service area. (Ex. 9, p. 30/31) San Gabriel requested three wells that were allowed in A.02-11-044 to be completed in 2003. San Gabriel, however, did not construct the wells. (Ex.45, p.8-8) The reservoir too was requested and allowed in A.02-11-044 for construction in 2003. The reservoir also was not constructed. The Company made the determination not to construct the plant. The fact the Company was allowed the

plant in A.02-11-044 and it was not constructed is evidence that projects requested are not necessarily required as the Company claims. DRA requested the Company provide statistics showing the facilities are required. San Gabriel's response did not provide statistics, and instead referred to the Master Plan. The testimony and responses of the company do not justify the reservoir cost at Plant F51. (Ex. 45, p.8-12/13) Based on the recommended disallowances for wells and reservoirs, Plant F51 should be disallowed. (Ex. 45, p. 8-15)

The Company is requesting that two wells, a million gallon reservoir and booster station be added at Plant F54 to keep pace with growth and balance the Baseline pressure zone. (Ex. 9, p. 31) The proposed addition at site F54 is planned to accommodate growth, reduce pressure in the Alder pressure zone and provide adequate pressure in the Baseline pressure zone. Land has not been acquired for site F54, a site has not been definitely identified and the need is attributed to future growth. When that growth occurs, the new customers should pay for the plant required to serve them. DRA removed the costs for plant F54 from the Company's request because the costs are not justified. (Ex. 45, p. 8-13/14)

6. SCADA System

The Company is in the process of constructing a Supervisory Control and Data Acquisition System (SCADA system) to replace its telemetry system. The equipment has been purchased, programming is nearly complete and the installation is scheduled to be completed by November 2005. The company has budgeted \$2.1 million for the project in 2005. (Ex. 9, p.32/33)

DRA has not taken exception to the proposed project costs.

7. Security Equipment

San Gabriel has budgeted \$1.5 million for the cost of new security devices. The cost prepared by Tesco Controls, Inc., was based on USEPA-mandated vulnerability assessment completed by Fontana Water Company. (Ex. 18, p. 11)

DRA has not taken exception to the proposed project costs.

8. Emergency Generators

To ensure a reliable supply of water to its customers and to ensure the system does not de-water during power outages or other emergencies, the Company plans to construct emergency generators at nine locations. The locations are Plants F2, F9, F13, F17 F47, F48, F15, F16 and F37. (Ex. 9, p. 35)

San Gabriel has requested nine new emergency generators. The Company has been able to maintain its operations to date without the extra generators because due to the short duration of any outage, the Company has been able to keep the system pressurized. Based on the response to Data Request GRC-007-39, San Gabriel has six generators (1 portable) that have been utilized nine times since 2002. In A.02-11-044, San Gabriel requested four emergency generators. That request was approved. In San Gabriel's response to data request GRC-007-39, San Gabriel indicated that it had not acquired a generator since the year 2000, once again proving that a request for an addition to plant that was previously allowed based on a "perceived" need, does not guarantee that San Gabriel will make such authorized acquisitions. DRA is not questioning the need for the generators because of the possibility of an emergency.

DRA, however, feels the Company's request is excessive under the circumstances. DRA recommends that of the nine generators requested, San Gabriel should be allowed to acquire five for inclusion in plant. The disallowed generators were those proposed for at the same wells and/or reservoirs that DRA has recommended be disallowed. DRA recommends that three of the five generators that the Company is allowed to acquire should be portable generators to allow for more versatility in responding to an emergency. To avoid a recurrence of the request in the future, San Gabriel should be required to provide evidence of the acquisitions prior to the next GRC. (Ex. 45, p. 8-14/15)

9. Water Transmissions and Distribution Mains

San Gabriel has added to Account 343 - Mains \$5,005,000 in 2005, \$3,420,000 in 2006, \$9,100,000 in 2007 and \$7,010,000 in 2008. San Gabriel's supporting workpapers,

however, show that the appropriate amounts to be added should have been \$7,405,000 in 2005, \$5,820,000 in 2006, \$8,950,000 in 2007 and \$6,860,000 in 2008. The workpapers show an annual amount for advances of \$2,220,000 and an annual amount for CIAC plant of \$180,000. The Company's summary schedule (FP1) shows \$0.00 in 2005, \$0.00 in 2006, \$2,250,000 in advances and \$300,000 in CIAC in each year 2007 and 2008.

As shown on Attachment C to the DRA's Direct Testimony, the amount of additions to Account 343 - Mains averages approximately \$5 million a year. The Company's projections exceed the average amount in each year, plus the Company's cost projections in 2005 are being increased by \$2,500,000 for the proposed line from the Sandhill Plant to Plant F13. The response to Field Visit Request (10/25/05 to 10/27/05) number 1, which requested the current percentage of completion of the projects included in the filing, does not reveal any progress on this specific job.

The projected 2007 costs include \$2,200,000 for the Cucamonga Valley Interconnect and \$3,000,000 for miscellaneous. The Company has provided sufficient justification for the Cucamonga Valley Interconnect project cost. The projected 2008 cost includes \$4,000,000 for miscellaneous. It is disconcerting when the Company labels a major cost component of its projected additions as "miscellaneous," especially when the Master Plan in Chapter 8 provides a detailed listing of pipes and locations that require replacement. The Company's request appears high when compared to the five-year average of annual additions to Mains funded by San Gabriel. Moreover, miscellaneous expenses cannot serve as an adequate justification for an expense of this magnitude.

As shown on the DRA's Direct Testimony, Attachment C, the average of additions for mains is \$5,111,000. Using the Company's estimate for annual contributions of \$2,220,000 and the estimated CIAC of \$180,000, the Company-funded amount would be \$2,711,000 (\$5,111,000 - \$2,220,000 - \$180,000).

The projections include uncertainty and speculative additions. Allowing for approximately \$2,800,000 a year for Company-funded projects other than special projects, the annual projected amounts should be reduced by \$620,000 in 2006,

\$1,550,000 in 2007 and \$1,660,000 in 2008. Also, absent any documentation showing the Sandhill and F13 project being completed, the \$2,500,000 for the connection should be removed from 2005. (Ex. 45, p. 8-17/18)

10. Cucamonga Connection

The Company is requesting to add the Cucamonga Connection to provide sufficient supply for the Hunters Ridge development for emergency purposes. As indicated in the main discussion, San Gabriel has provided cost justification for this project and DRA allowed the project in its recommended plant cost. Its limited availability, however, is a concern that may suggest that the need for the facility has not been established.

According to Mr. LoGuidice, the Company budgeted \$2.2 million in 2007 to install 8,800 feet of pipe and booster station needed to supply water from Cucamonga Valley Water District's ("CVWD") Lloyd Michael water treatment plant. Without it Hunters Ridge could be without water if Plant F15 were shut down for more than a few hours. (Ex. 9, p.34)

The Company is requesting a Cucamonga Valley emergency connection, which is the equivalent of 14.4 million gallons per day that would only be available during periods of emergency when Cucamonga Valley Water District had water available. (Tr. Vol. 3, p. 177/178, LoGuidice/San Gabriel)

In addition, the Cucamonga connection cannot be relied upon to meet demands in a typical summer day. The connection certainly would not be relied upon to meet demands during an entire summer. (Tr. Vol. 3, p. 179, LoGuidice/San Gabriel) While the DRA has not removed the cost from plant, the Company's lack of confidence in the reliability of the connection to meet demand, this may justify excluding the cost from plant.

11. New Office and Operations Center

a) Purchase of Land From Affiliate

San Gabriel has planned the construction of a new office/warehouse for its Fontana operations. The proposed structure will also serve as a facility for some general office personnel, such as the Engineering Department. DRA toured the current facilities of the Company, which will be replaced by the new complex and observed the physical condition as well as the employee work areas. DRA does agree that a new facility would provide a more conducive work environment.

DRA has many concerns regarding the acquisition of the property First San Gabriel acquired the property (4.8111 acres) for the new facility, located at 8406 Tokay Avenue, on December 30, 2004 for \$1,102,233 from Rosemead Properties, Inc, an affiliate company of San Gabriel. The acquired parcel 0232-081-64 of 4.8 acres was part of an 8.72 acres originally acquired by Rosemead Properties, Inc. on July 8, 2003 for \$1,148,272. On January 6, 2004, San Gabriel entered into a Letter Agreement dated October 20, 2003 with the Earl Corporation for the design and construction of the office facilities at Arrow Highway/Tokay Avenue. San Gabriel did not acquire the site from its affiliate until December 30, 2004. Finally, San Gabriel paid for the demolition of a residential structure including asbestos abatement work at 8406 Tokay Avenue in March of 2004, prior to its actual acquisition of the property. (Ex.45, p.8-19/20)

Mr. Nicholson calculated the purchase price of the property for Rosemead Properties to be \$126,000 per acre and the price to San Gabriel for the property to be approximately \$234,000 per acre. Mr. Nicholson indicated that the property appreciated that much in a year and a half based on the appraisal. (Tr. Vol. 3, p.289, Nicholson/San Gabriel)

DRA recommends that the cost of the land acquired for the office building be reduced based on the cost by San Gabriel's affiliate Rosemead Properties, Inc. (Ex. 45, p. 8-2) DRA's recommendation coincides well with ALJ Barnett's recommendations made on the last day of evidentiary hearings on January 20, 2006, where he stated that the

Rosemead property should be one half of what the company paid for it. “The ratio 4.8 to 8.72 the acreage ratio. It is an affiliated transaction, and there will be no gross-up in that kind of deal...The purchase price of \$1,148,272. That is what I’m going to allow, the ratio, 4.8.” (Tr. Vol. 8, p.779, ALJ Barnett) Affiliate transactions of this type are immediately suspect. And this example illustrates why the Commission's skepticism about these types of arrangements is justified.

b) Construction Expense

San Gabriel estimates the cost of the new facility will be \$6,000,000. DRA requested the Company in MDR II.A.11 to provide a copy of the work order, a cost breakdown and justification for the project, with any cost-benefit analysis. San Gabriel assigned the office/warehouse project, work order number 4556, but the response to MDR.II.A.11 did not provide any support for the project. The Company proposes that the cost be included in rates through an Advice Letter. DRA does not agree with this request.

San Gabriel paid for the demolition of a residential structure, including asbestos abatement work at 8406 Tokay Avenue in March of 2004, prior to its actual acquisition of the property. (Ex. 45, p. 8-20) Mr. Nicholson indicated that San Gabriel paid for the building that was demolished while the land was still owned by Rosemead Properties. (Tr. Vol. 4, p. 302, Nicholson/San Gabriel) DRA notes that San Gabriel had not sought Commission approval of this transaction before pursuing this arrangement with its own affiliate.

The proposed new office complex of 40,658 square feet is approximately twice the size of the six facilities (20,827 square feet) it is designed to replace, and San Gabriel maintains that it still needs to retain a 2,300 square foot building of the existing structures for a satellite customer service office. The new office complex includes approximately 11,548 square feet of office and general space for employees that previously occupied 4,719 square feet of space. (Ex. 45, p. 8-20/21) In the last rate case, the site plan had a

gross area of 110,613 square feet and a two story office building and warehouse with 28,740 square feet. (Tr. Vol. 3, p. 240, McGraw/San Gabriel)

The Company's witness Mr. McGraw indicated that the need for the office in the last rate case and in this rate case is basically the same. The Company had originally requested \$3,000,000 in the last rate case. (Tr. Vol. 3, p.238/239, McGraw/San Gabriel) The current site area is 205,140 square feet, and the office and warehouse is 40,485 square feet. The increase in area according to Mr. McGraw, is because the original site didn't accommodate all of San Gabriel's needs. (Tr. Vol. 3, p. 241, McGraw/San Gabriel) Mr. McGraw believes that a space analysis was performed, but it was not filed with his testimony or provided to DRA. (Tr. Vol. 3, p. 246, McGraw/San Gabriel) Mr. McGraw believes that the Company is asking the Commission, by way of Advice Letter, to authorize a building without knowing the unit cost for the building. (Tr. Vol. 3, p. 263/264, McGraw/San Gabriel)

In the last rate case, A.02-11-044, San Gabriel requested \$3 million for the construction of a new office and during the proceeding, the request was increased to \$6 million. The Commission deferred the decision to this GRC filing. The order stated that if the Company were to request authorization to proceed with the new building, it should provide complete justification for the building and it should address the ratemaking treatment of the proceeds from the sale of the existing facilities.

However, the only detailed cost information provided is Attachment A to Company witness Michael McGraw's testimony, and that cost information consists of a \$4.9 million estimate to refurbish the existing facilities. The proposed facility is excessive when compared to the old facilities to be replaced, which had large areas that were unoccupied or were used for limited storage. The \$6 million request exceeds the \$4.9 million cost to refurbish the existing facilities. The Company has not provided any justification for the cost of the new office/warehouse, addressed either the ratemaking treatment for the existing facilities as ordered or even committed to disposing of the existing facilities. (Ex. 45, p. 8-21)

c) Use and/or Disposition of Existing Facilities

As stated previously, the order in A.02-11-044 stated that if the Company were to request authorization to proceed with the new building, it should provide complete justification and should address the ratemaking treatment of the proceeds from the sale of the existing facilities. (Ex. 45, p.8-21) The Company has not addressed the ratemaking treatment for the existing facilities as ordered or even committed to disposing of the existing facilities. (Ex. 45, p. 8-21)

d) DRA's Recommendations on New Office

In the last rate case, A.02-11-044, San Gabriel requested \$3 million for the construction of a new office. During the proceeding, the request was increased to \$6 million. The Commission deferred the decision to this GRC filing. The order did allow San Gabriel to acquire the land and include it in plant. Again, the order also stated that if the Company were to request authorization to proceed with the new building, it should provide a complete justification and it should address the ratemaking treatment of the proceeds from the sale of the existing facilities. Again the only detailed cost information provided by San Gabriel consists of a \$4.9 million estimate to refurbish the existing facilities.

The proposed facility is excessive when compared to the facilities to be replaced. The \$6 million request exceeds the \$4.9 million cost to refurbish the existing facilities. The Company has not provided any justification for the cost of the new office/warehouse, addressed either the ratemaking treatment for the existing facilities as ordered or even committed to disposing of the existing facilities.

DRA recommends that 50%, or \$3,000,000 of the proposed cost of \$6 million of the requested cost be phased into CWIP during the years 2006 and 2007. San Gabriel should also be required to dispose of the facilities that are to be replaced or actually dispose of the facilities via an arms-length transaction to an unrelated, third party, with the benefit of the sale going to ratepayers. (Ex. 45, p. 8-21/22)

For ratemaking purposes, the recommended amount for the new facility should remain in CWIP to allow the Company an opportunity to earn a return on the cost of the

facility that may be found to be used and useful in the future. In the next rate case proceeding, the costs should then be reviewed for prudence and the facility's size can be evaluated to determine whether the facility is used and useful for the operations of the Fontana Water Division. All gains derived from the sale of the existing facilities should then be returned to ratepayers by offsetting the cost of the new facilities. (Ex. 45, p. 8-22)

C. Construction Work in Progress ("CWIP")

The Company utilized the CWIP balance as of December 31, 2004 in each rate year. The December balance was higher than the historical CWIP balance because of the major projects currently in progress. The projects included the Sandhill Plant modification, the new office complex, the SCADA system and cost for Plant F7 as shown on Attachment D to the DRA's Direct Testimony. Each of the projects included in CWIP are projects the Company has included in the requested plant additions in the filing. The inclusion of the cost in CWIP and in plant represents a double count of a portion of the requested plant costs.

Mr. Dell'Osa, the witness responsible for CWIP did not know whether the plant amounts requested were adjusted downward to account for the amount reflected in CWIP. The Company has not met its burden of proof in justifying the CWIP balance included in its rate request. DRA has appropriately reduced the CWIP balance for the double count and adjusted the balance to properly reflect a portion of the requested office complex.

Instead of using an average balance, San Gabriel has requested that its December 2004 CWIP balance of \$7,700,400 be included in rate base in each of the rate years. As shown on Attachment D to DRA's Direct Testimony, the thirteen month average for CWIP over the last 6 years has ranged from \$1.6 million to \$6.4 million. The \$6.4 million is high because it includes the long-term projects for the Sandhill Plant and the new office complex. The Company's \$7.7 million balance includes the Sandhill project, the new office project, the SCADA project, and the project at Plant F7. (Ex. 45, p. 8-22)

The SCADA project and the project at F7 are significant and the Company is reflecting them in the 2005 plant additions. DRA proposes to reflect a portion of the costs of the new office facility in CWIP over the projected rate years. DRA's proposal is to begin with a normalized level of CWIP, and then include additional amounts in each of the rate years for the plant additions under construction at the new office complex. (Ex. 45, p. 8-22)

In determining our recommended CWIP balance shown on Attachment D, DRA started with San Gabriel's recommended year-end amount and removed the costs for the Sandhill Plant, the new office, the SCADA system and the costs for Plant F7 to avoid duplicating any costs reflected in 2005 additions or being added back as part of our recommended treatment for the costs of the office complex resulting in a normalized CWIP balance of \$3,900,600. The \$3.9 million amount is approximately the same as the most recent five-year average for CWIP of \$3.8 million. (Ex. 45, p. 8-22/23)

DRA then added the December 31, 2004 CWIP balance for office and then a portion of the estimated \$3 million of recommended costs to the CWIP balance for the office complex to get the projected CWIP balance for 2005. Costs were added in 2006 and 2007 for the office project to get the projected CWIP balance through 2007. And that 2007 balance was carried over into 2008 and 2009. As discussed above, the prorated costs for the office complex in CWIP will allow the Company the opportunity to earn a return on the amount of plant tentatively estimated to be used and useful to ratepayers until the final costs is determined and the facilities are in operation. (Ex. 45, p. 8-23)

During the evidentiary hearings, Mr. Dell'Osa stated that the amount of CWIP reflected in filing was higher than it has been in past years. (Tr. Vol. 4, p. 352, Dell'Osa/San Gabriel) Mr. Dell'Osa agreed that the CWIP balance did include the SCADA cost and cost for Plant F7, but he did not know whether the plant amount requested was a double count of the CWIP amount. He is "assuming" that Mr. LoGuidice put in added dollars into plant not expenditures made in prior years. (Tr. Vol.

4, p. 353, Dell'Osa/San Gabriel) These types of assumptions fail to meet San Gabriel's burden of proof to establish the reasonableness of expense estimates.

D. Materials and Supplies

San Gabriel determined its projected material and supplies by calculating a five-year average of historical materials and supplies in 2004 dollars. The Company then increased the average for the percentage increase in plant projected and the non-labor inflation rate. DRA disagrees with San Gabriel's calculated projection because the application of the growth rate in plant is not justified. The average plant balance increased approximately 10% in 2004, but the average materials and supplies decreased by approximately 16%. And the average plant balance in 2003 was approximately 11% higher than 2002, and the average materials and supplies for 2003 was approximately 3% higher than 2002. Thus, San Gabriel's growth factor is not justified. (Ex. 45, p. 10-3)

Additionally, Mr. Dell'Osa agreed that there was a year when the plant balance increased that the materials and supplies balance decreased. (Tr. Vol. 4, p. 354/355, Dell'Osa/San Gabriel)

DRA recommends that the five-year average materials and supplies balance be adjusted for inflation only, using the updated inflation factors previously discussed. Thus, DRA's recommendation results in a reduction to the Materials and Supplies included in rate base of \$238,300 in Test Year 2006-2007 and \$326,200 in Escalation Year 2007-2008. (Ex. 45, pp. 10-3 – 10-4). The resulting materials and supplies balance to be included in rate base is \$766,300 in Test Year 2006-2007 and \$781,200 in Escalation Year 2007-2008 (Exh. 45, pp. 10-7 and 10-8) As shown above, the change in plant does not always reflect a similar change in the level of materials and supplies. Because a direct connection does not exist, DRA recommends the materials and supplies amount be adjusted for inflation only.

E. Contributions and Advances

1. Advances for Construction

San Gabriel reflected in the plant balance the same amount of advances for construction that are being reflected in the projected advance credit balance that offsets rate base. The additions to the advance account for the past five years averaged \$3 million. The additions projected for 2005-2008 average \$2 million. (Ex. 45, p. 10-2)

Historically, the \$3 million represented approximately 26% of the \$11.677 million average of gross plant additions. The projected \$2 million average of advances is approximately 11% of the \$18.379 million average plant additions estimated by San Gabriel for the years 2005-2008. The difference between the actual levels and the estimated amounts included in the filing suggests that San Gabriel understated the projected advances for construction. However, after applying DRA's recommended adjustments to plant, the projected average advances included in the filing to the DRA's proposed average gross additions is approximately 28% and is considered reasonable. (Ex. 45, p. 10-2) Thus, DRA did not reflect an adjustment to increase the amount of advances for construction from the amount contained in the filing.

The Company's Master Plan attributed the additional plant requirements to growth in the Fontana Division. The growth that creates the need for additional plant should be either advanced or contributed by developers. The plant recommended by DRA for disallowance was projected to be Company-funded, not funded by customer advances. To the extent that any of the plant recommended for disallowance is allowed by the Commission, then that plant should have some offset reflected based on the historical relationship of advances to gross plant additions for the advance amount reflected as an offset to rate base. (Ex. 45, p. 10-2)

2. Contributions in Aid of Construction (CIAC)

San Gabriel reflected the same amount of contributions that are being reflected in the projected contributions credit balance that offsets rate base. The additions to the contributions in aid of construction for the past five years averaged \$1.3 million. The

additions projected for 2005-2008 included in the Company's filing average \$850,000. (Ex. 45, p. 10-2)

Historically, the \$1.3 million represented approximately 11% of the \$11.677 million average of gross plant additions. The projected \$850,000 average for contributions is approximately 5% of the \$18.379 million average plant additions estimated for the years 2005-2008. The difference between the actual and the estimates suggests that San Gabriel understated the projected contributions. (Ex. 45, pp. 10-2 – 10-3)

After applying DRA's recommended adjustments to plant, the projected average contributions to projected average gross additions is approximately 12% and is considered reasonable. (Ex. 45, pp. 10-2 – 10-3) Thus, DRA is not recommending an adjustment to the amount of CIAC included in San Gabriel's filing. The Company's Master Plan attributed the additional plant requirements to growth in the Fontana Division. The growth that creates the need for additional plant should be either advanced or contributed by developers.

DRA's recommended plant disallowance was projected to be Company-funded. To the extent that any of the plant recommended for disallowance is allowed by the Commission, then that plant should have some offset reflected based on the historical relationship of contributions to gross plant additions for the contributed plant amount reflected as an offset to rate base. (Ex. 45, p. 10-3) To the extent that any of the adjustments to reduce plant additions recommended by the DRA for disallowance is not adopted by the Commission, the Commission should reflect an increase in CIAC based on the historical percentage relationship of CIAC to plant additions. As indicated above, the historic percentage of average contributions to average plant additions is 11%. Following DRA's recommendation assures ratepayers that plant additions paid for by contributions, or CIAC, are not recovered twice by San Gabriel- once through receipt of the Contribution in Aid of Construction and once from ratepayers in rates.

F. Working Cash

San Gabriel reflected a cash requirement in rate base for operating cash of \$11,900 that consists of minimum cash balances and/or deposits and the second cash requirement

based on the Company's lead lag study. In its testimony, San Gabriel questions the applicability of Standard Practice U-16. The Company's calculation, consistent with its calculation in A.02-11-044, ignores the working cash the Company has on hand that is not supplied by shareholders.

DRA reviewed the Company's lead lag calculations and has identified at least one error. The lag for power costs is understated because San Gabriel used the bill preparation date as the end of the service period in determining the lag from the end of service to the payment date. Southern California Edison has a long billing lag for service, as evidenced by a review of their bills. DRA analyzed the Southern California Edison bill prepared February 10, 2004 and determined that the weighted average payment lag was 33.8 days compared to the 19 days used by the Company. The combined service and payment lag weighted average for power costs was 46 days compared to the Company's lag of 34 days. (Ex. 45, p. 10-4)

San Gabriel used the lead lag calculation to determine the cash requirement while ignoring any non-investor supplied cash. This approach, however, does not properly reflect the true working capital requirements of the Company. For example, rate base includes the Tax on Advances and Contributions that are prepaid, but no offset is reflected for the liability on the books for taxes collected for advances and contributions. The taxes collected are funds the Company has collected, but has not disbursed. As of December 31, 2004, the taxes collected for advances and contributions total \$596,896. This is a source of non-investor cash that needs to be recognized as an offset to working capital. (Ex. 45, p. 10-4/10-5)

The Company receives advances from developers and recorded the advances on its books in Accounts 30-242-41 and 30-242-65. San Gabriel, did not reduce the rate base for the advances because it claims there is no asset in rate base associated with these funds.

The Company's responses to Data Requests GRC-007-42 and 43 state that once a developer decides on a job that the Company has prepared an estimate on, then "a deposit

for the full estimated construction cost” is required. The response then states “Upon completion of the project, all jobs that have accumulated charges are closed by capitalizing the actual construction costs to the appropriate utility plant account and crediting the corresponding advance account.” Based on that statement, San Gabriel’s claim that an asset is not yet in rate base is not totally accurate. That asset is in rate base in either CWIP or as part of the working capital amount that reflects cash needed in the daily operations of the Company.

If the cost of the job is recorded prior to the advance is transferred, then a cash requirement occurs. It would not be appropriate to ignore the fact that the developer has advanced the cash when determining working capital. The total amount of advances for Accounts 30-242-41 and 30-242-65 at December 31, 2004 were \$5,877,531. The amount should be reflected as a reduction to the working capital requirement if it is not reflected as a separate rate base offset.

Another liability for non-investor supplied funds is Account 30-242-60 - Miscellaneous (Pending Refunds). As of December 2004, San Gabriel had the use of \$121,147 of funds that were not supplied by investors. The funds should be reflected as a reduction to working capital. (Ex. 45, 10-5) The amount in this account represents excess funds advanced by customers for construction projects that are completed. Until the funds are returned to the customer, the funds are a cost free source of cash for the Company to use in its day to day operations.

The Company’s Working Cash-Lead Lag of \$774,800 for 2006-2007 should be reduced by the \$6,595,574 of non-investor funds available to the Company for its day to day operations, this adjustment results in an adjusted Working Cash-Lead Lag of a negative \$5,820,774. The 2007-2008 Working Cash-Lead Lag of \$878,500 should be reduced by the \$6,595,574, resulting in a negative \$5,717,074 working capital requirement. (Ex. 45, 10-6)

G. Depreciation

The differences between DRA's and San Gabriel's estimates are the result of DRA's recommended additions to plant in service and advances. These differences have been discussed above. In addition, San Gabriel's reserve calculation included a mathematical error in the calculation of Net Plant Retirements.

San Gabriel determined its accumulated depreciation by first adding the projected depreciation for the year to the previous year-end balance. Next, the Company adjusted the balance for the five-year average of net plant retirements. The net plant retirements are the plant retirements plus or minus the plant salvage and/or cost of removal.

DRA determined that there was a mathematical error in the Company's calculations by comparing the balances for accumulated depreciation for 2005 on Company Workpaper FP6 (page 8) and Company Workpaper for Table 9B on page 226. The difference between the year end balances on the respective Workpapers is due to the Company reducing the reserve balance on one Workpaper for the salvage and/or cost of removal amount, and on the other Workpaper, San Gabriel added the salvage and/or cost of removal amount. A review of the historical data that was used to determine the averages in the calculation confirmed that the amount in the filing was incorrect. (Ex. 45, p.9-1) Company witness Daniel Dell'Osa agrees in his rebuttal testimony that the negative net salvage was mistakenly added, rather than subtracted, from the depreciation reserve, and that the correction reduces the Company's forecasted rate base. (Ex. 20, p. 25)

DRA determined the depreciation rates used by the Company are appropriate and have applied those rates to DRA's recommended plant in determining the depreciation expense. (Ex. 45, p. 9-2) The result in DRA's recommended Test Year 2006-2007 depreciation expense of \$3,517,600, which is a \$445,200 reduction to the amount proposed by San Gabriel, and a \$776,000 reduction to the average Test Year 2006-2007 depreciation reserve, resulting in an average depreciation reserve offset to rate base of \$43,183,900. (Ex. 45, p. 9-3) For Escalation Year 2007-2008, DRA's recommended depreciation expense is \$3,694,200, which is \$592,100 less than the amount proposed by

San Gabriel. For that same year, DRA's recommended average depreciation reserve offset to rate base is \$47,019,500, which is \$1,383,800 less than San Gabriel's projected amount. (Ex. 45, p. 9-4)

X. COST OF CAPITAL

DRA and San Gabriel have reached a Settlement Agreement on Cost of Capital. The agreement reached is contained on Joint Exhibit 85. As shown in Exhibit 85, the agreement between the DRA and San Gabriel results in an overall rate of return of 9.33% for Test Year 2006-2007 and 9.35% for Escalation Year 2007-2008. DRA has flowed through the 9.33% rate of return for Test Year 2006-2007 in its final position column on the Joint Comparison Exhibit, Exhibit 88.

A. Capital Structure

The Settlement Agreement between DRA and San Gabriel results in a capital structure consisting of 40% long-term debt and 60% equity. (Ex. 85)

B. Effective Cost of Long-Term Debt

The Settlement Agreement between the DRA and San Gabriel results in a cost of long-term debt for each year, 2006 through 2008, based on the amounts proposed by San Gabriel in its filing. The agreed upon long-term debt rates are: 8.44% for 2006, 8.49% for 2007, and 8.54% for 2008. (Ex. 85)

C. Equity Cost

The Settlement Agreement between the DRA and San Gabriel includes a cost of equity of 9.90%. (Ex. 85)

XI. REVENUE RECOVERY ISSUES

A. Advice Letter Treatment

1. Sandhill Treatment Plant

San Gabriel has requested Advice Letter treatment for two major capital projects contained in its filing. These consist of the post-2005 projected Sandhill Water Treatment Plant Upgrade costs and the new office facilities consisting of a new office, garage, warehouse and storage yard facilities. DRA disagrees with the proposed advice

letter treatment for the capital projects. DRA addressed Advice Letter treatment for the Sandhill Water Treatment Plant Upgrade earlier in this brief, under the discussion of the upgrade project. DRA recommends that the cost of the Sandhill Water Treatment Plant Upgrade be removed from plant, and that the proposed Advice Letter treatment for the incremental costs be disallowed. The next General Rate Case is the proper time to make a determination of whether the cost of the upgrade is appropriate, since by that time the new plant should be operational and its capacity can be readily determined. The Company can accumulate charges for Interest During Construction so that its investment is protected until such time as a final determination on the project can be made. (Ex. 45, pp. 8-16 to 8-17)

2. Office and Operations Center

DRA addressed at length the office and operations center previously in this brief. Additionally, DRA does not agree with the Company's proposal that the costs associated with the facility be included in rates via Advice Letter. The Commission should deny the requested advice letter treatment. DRA already previously addressed the numerous concerns regarding this proposed project.

3. Water Treatment Operators

As discussed previously, DRA recommends San Gabriel be permitted to hire employees to fill four additional Water Treatment Operator III positions. These positions are to meet the new staffing requirements at the Sandhill Water Treatment plant that results from the upgrades. Because the plant is not anticipated to be in service until August 2007 or later a later period that falls outside of Test Year 2006-2007 allowing recovery of additional expenses beyond the four positions for this facility is premature. As discussed previously, DRA recommends that San Gabriel be allowed recovery of the four new Water Treatment Operator III positions after the Sandhill Water Treatment Plant upgrade is in service and the positions are actually filled by San Gabriel via Advice Letter. (Ex. 45, p.13-3)

B. Memorandum Accounts

1. Water Quality Litigation Memorandum Account

San Gabriel is requesting authority to amortize costs recorded in its Water Quality Litigation Memorandum Account. According to San Gabriel, it projects an undercollected balance in the account of \$2.3 million as of December 31, 2005. (Ex. 24, p. 12) San Gabriel did not include costs for this request in its revenue requirement calculations. According to the Application, San Gabriel is seeking authority to amortize at a date prior to the final decision in this case, any remaining balance recorded in its Water Quality Litigation memorandum account. (Ex. 45, p. 13-1)

In D.04-07-034, the Commission approved the amortization over twelve-months of Water Quality Litigation Balancing Account costs as of June 2003 of \$1,027,047. In March 2005, San Gabriel submitted Advice Letter 334-W seeking the amortization of subsequent amounts accrued to the memorandum account, totaling \$1,163,198. (Ex. 45, p. 13-1) On March 14, 2006, the Water Division issued a Draft Resolution W-4590 that denied San Gabriel's requests seeking to recover legal expenses in the Water Quality Legal Memorandum Account without prejudice because this issue is currently being litigated in this proceeding.

According to the testimony of San Gabriel witness Daniel Dell'Osa, San Gabriel is not seeking to recover the same balances it has already requested in the prior case and via Advice Letter 334-2. According to Mr. Dell'Osa, any amounts the Company is authorized to amortize in the pending advice letters, or future advice letters, are excluded from San Gabriel's current application. (Ex. 8, p. 34) DRA has confirmed that the expenses associated with water quality litigation have not been included in the expenses contained within the filing, nor is an amortization of past amounts included in the revenue requirement calculations. (Ex. 45, p. 13-2)

DRA agrees that the water quality litigation costs incurred should continue to be accounted for via a balancing account and the expenses associated with water quality litigation should be excluded from the base rates calculated in this case. DRA, however, takes issue with the requested timing of the amortization of the costs contained in the

Water Quality Litigation Memorandum Account. DRA recommends that the costs continue to be deferred until the amount of recovery of the litigation costs from third parties can be determined, and until such time as the outcome of the costs is known. (Ex. 45, p. 13-2)

When asked during hearings if the Company anticipated the recoveries from polluters would exceed the legal costs being incurred, Company witness Dan Dell'Osa indicated that the Company hopes so. (Tr. Vol. 4, pp.357 – 358, Dell'Osa/San Gabriel) Company witness Michael Whitehead was also asked during hearings whether, in his opinion, the perchlorate related legal efforts of the Company will result in the ultimate recovery of costs from polluters. His response was as follows:

A Well, I believe it will, because -- and the reason, as I've stated in my testimony, that I believe that -- and there are several reasons. First, we believe that there is compelling evidence that the polluters who have so far been identified bear responsibility for the contamination.

Number two, the company has retained highly skilled and talented legal counsel to represent it; the same talented legal counsel that achieved a very significant recovery of perchlorate related costs and damages in the San Gabriel Valley, which I believe I testified are worth to the company in excess of \$100 million.

And every penny that we recover to build plants -- and we're building two \$25 million plants in the Los Angeles County Division. Every penny that we got for that is contributions in aid of construction. And every penny to operate those plants, which will be every penny of the cost of operating those plants, will be recovered. And that's flowed through to the ratepayers.

That's a very significant recovery. And I point to that because that's a model in these -- in these situations. And I'm not exaggerating. In fact, I'm probably understating the value of that -- the benefit to ratepayers.

And, yes, we had to spend money to achieve that, through expert legal counsel and expert witnesses and consultants, but -- but the achievement of restoring polluted groundwater supplies, and doing so in a way that the customers are shielded from those costs, seems to me to be a very worthy endeavor.

We're working to achieve similar results in the Fontana Rialto groundwater contamination plumes. There are no guarantees when you go into court, your Honor, but we have reason to believe that we have a very compelling case to make. And we have creative legal counsel.

As I've stated yesterday, it's not our intention to go in with scorched-earth litigation and spend the kind of money -- the \$10- to

\$12 million that the City of Rialto attorney said in this case that Rialto is spending. That does not seem to be a wise thing to do.

Nonetheless, we have demonstrated our ability to engineer very successful outcomes with responsible parties -- polluters, whatever you want to call them -- without having to go through literally a decade of litigation to do it.

So I know that's a long answer to your question, but I want you to understand that we have, I think, very good reason to believe that we are going to achieve significant recoveries. I can't predict when that will happen or if it will be 100 percent or not. Our track record indicates that we're probably going to do a good job.
(Tr. Vol. 8, pp.763 - 764, Whitehead/San Gabriel)

Clearly, the Company anticipates that the costs it is incurring for the water quality litigation, which it is recording in the Water Quality Litigation Memorandum Account, will result in significant future recoveries, which is anticipated to exceed the legal costs incurred. Therefore it is wrong to charge the current ratepayers with the legal expenditures by annually including the amortization of the balancing account in rates when it is the future ratepayers who will receive the benefit of the costs. It is future ratepayers that will receive the benefits of the Company's efforts. Thus, DRA strongly recommends that these expenditures continue to be deferred to be matched up with the future benefit that will result. In the meantime, the Company is not harmed by the deferral of these costs as the balancing account accumulates interest. With this account the Company will be made whole in the future for its pollution recovery legal expenditures, plus interest.

In D.04-07-034, the Commission specifically addressed this issue as follows: "We conclude that, as recommended by ORA, costs of outside legal services related to perchlorate contamination should be excluded from test year expense and be recorded in a memorandum account. A final accounting is necessary after payments are received from condemnation suits to determine the proper allocation of these payments between ratepayers and shareholders." See *33. These cases have not yet been resolved. Consequently, DRA recommends the litigation costs continue to be deferred until such time as the outcome of the litigation and incurred litigation costs are known. (Ex. 45, p. 13-2) The future ratepayers who receive the benefit of these expenditures should also be

responsible for the prudently incurred costs needed to receive those benefits, not current customers.

2. Water Quality Memorandum Account

In San Gabriel's last rate case, D.04-07-034, the Commission approved a water quality memorandum account to cover costs incurred and proceeds recovered from polluters or grants received from governmental agencies related to water quality that were not included in rates. DRA recommends that this memorandum account continue so that amounts received from polluters or grants received in the future, which are not included in the rates that will result from this case, may benefit ratepayers in the future. (Ex. 45, p. 13-3)

XII. RATE DESIGN

A. Facilities Fee

At the hearings, on January 18, 2005, ALJ Barnett stated as follows: "One of my recommendations to the Commission is going to be that there be a \$5,000 facilities fee per new hookup." As a result, ALJ Barnett requested that parties present, as Exhibit 62, the impacts of a \$5,000 facilities fee for the test year and each escalation years, with the revenues from the facilities fee to be treated as contributions in aid of construction. The impacts include the effect on rate base and on revenue requirement. (Tr. Vol. 6, pp.481 – 483, ALJ Barnett)

While it has not been the norm for the Commission to adopt facilities fees for new connections for water utilities, it has been done in past cases. As indicated by ALJ Barnett "... this is a somewhat radical proposal for the Commission, if they would accept it. I know they have accepted it in the past. And I've discussed this with the Water Division, and they feel that it is not in contradiction to any statute or Commission decision or rule of the Commission." (Tr. Vol. 6, pp. 486 – 487, ALJ Barnett) DRA agrees that this would be a reasonable outcome in this case, particularly considering the significant amount of plant investment the Company has projected going forward. While DRA is recommending numerous revisions to San Gabriel's proposed capital additions,

discussed in the plant section of this brief, a considerable amount of additions would still remain.

Unfortunately, DRA was not able to agree with the proposed Exhibit 62 prepared by San Gabriel. As a result, the DRA, the City of Fontana and the Fontana Unified School District have filed Joint Exhibit 62a, which provides the impacts of a \$5,000 facilities fee per new connection, assuming 1,300 new connections per year, with the appropriate offset to rate base as Contributions in Aid of Construction and the resulting impact on each year's revenue requirement, consistent with the explicit instructions of ALJ Barnett. DRA was unable to sign onto San Gabriel's proposal as it was not in compliance with ALJ's explicit directions in the January 18, 2006 hearing and is in conflict with several positions taken by the DRA in this case.

In its Exhibit 62, San Gabriel has presented the facilities fees as offsets to its proposed future advice letters for the Sandhill Treatment Plant Upgrade and the Office Complex, and not as a CIAC offset to rate base as instructed by the ALJ. DRA agrees that the impact, if the facilities fees are adopted, should be shown as an offset to rate base in the Test Year and each of the escalation years, consistent with the ALJ's instructions, and not as offsets to proposed future advice letters. In fact, as previously discussed in the Advice Letters section of this brief, DRA has specifically disagreed with San Gabriel's proposed advice letter treatment for both the Sandhill treatment plant upgrade and the office complex. Reflecting the impact of the facilities fees as offsets to rate base would not conflict with DRA's proposed Advice Letter treatments. The amounts collected as facilities fees could still avoid being treated as taxable revenues as the collections would be facilities fees that could go towards some of the other numerous proposed plant additions in this case.

As shown on Joint Exhibit 62a, DRA's proposal would reduce San Gabriel's revenue requirement to \$637,815 in Test Year 2006/2007; \$1,902,612 in Escalation Year 2007/2008 and \$3,137,472 in Escalation Year 2008/2009.

B. Monthly Service Charges

San Gabriel indicates that it prepared its filing in compliance with the Commission's Water Rate Design Policy set forth in D. 86-05-064 in I.84-11-041. This method, which was used in the filing, is based on 50% of fixed costs being included in the service charges, with remaining costs recovered through a single block commodity charge. (Ex. 45, p. 12-1) DRA reviewed San Gabriel's model used in allocating the revenue requirement between the customer classes and between the fixed costs and usage base costs and takes no issue with the methodology used by the Company.

In the last rate case, D.04-07-034, the Commission required San Gabriel to implement a low income rate program. Under the California Alternative Rates for Water (CARW), qualifying customers receive a 50% reduction to their monthly service charge. Within the rate design calculations presented by San Gabriel, the Company has assumed that 30.7% of Fontana Water Company's residential customers served through a 1" or smaller meter will qualify for the CARW program. The assumption's impacts are spread over all remaining service calculations in San Gabriel's filing. DRA takes no issue with the Company's assumptions and calculations regarding this program. (Ex. 45, p. 12-1)

XIII. WATER DIVISION AUDIT REPORT

A. Background

San Gabriel Valley has two divisions: the Fontana Water Company Division and the Los Angeles County Division. In the last Fontana rate case decision, D.04-07-034, the Commission ordered the Commission's Water Division to audit, prior to Fontana Division's next general rate case, all sale and condemnation proceeds received by San Gabriel from 1996 onwards. Although D.04-07-034 only pertained to the Fontana Division, the proceeds at issue also included proceeds from the Los Angeles County Division. Thus, the Water Division's Audit examined proceeds received by both the Fontana and Los Angeles Divisions. (Ex. 63, p.6)

Additionally, in the last Fontana rate case, the City of Fontana raised the issue of whether proceeds received by San Gabriel for sale from condemnation, service

duplication, and lawsuit settlements related to water contamination had been paid to shareholders in the form of dividends. San Gabriel claims that all the proceeds were reinvested in Section 790 plant infrastructure, but San Gabriel's actual behavior differs markedly from its claims. For example, in 1999, San Gabriel paid \$8,690,400 in dividends to its shareholders. This amount was comprised of \$3,729,600 of regular dividends and \$4,960,800 of special dividends. (Ex. 63, p.38) San Gabriel has offered no compelling explanation of the source of these funds. Again, this discussion of dividends only applies to the Fontana Division and not the Los Angeles County Division.

San Gabriel informed the Water Division that during the past 20 years, only one other special dividend was paid to shareholders, and that was for \$643,200 in 1989. Dave Batt, Vice-President and Treasurer, testified in the last Fontana rate case that the 1999 special dividends came from utility operations. The City of Fontana suspected that the dividends may have been paid from proceeds received from contamination proceeds. *Id.*

The Water Division reviewed the audited financial statements of San Gabriel from 1990 to 2004 and the Statements of Cash Flow for those years, and applied analytical procedures on the data in those statements. Based on this analytical review, Staff found the following cash flow for the period 1990 to 2004:

Cash Flow (1990-2004):

	\$
Cash from Operations	189,214,833
	\$
Add: Net Borrowings ¹	24,572,500
	\$
CIAC and Advances	63,036,637
Less: Capital Expenditures (CIAC/Advances))	\$

¹ Staff assumes net borrowings were used for capital expenditures, and not for payment of dividends. If SGV claims that some of the net borrowings were used for payment of dividends, Staff finds this may violate Section 817, and also raise the issue of what interest costs ratepayers may have borne for those borrowings used to pay dividends. Staff finds that it is not just and reasonable for ratepayers to pay, through rates, interest costs for borrowings that are used to pay dividends to shareholders.

		(63,036,638)
	Capital Expenditures (Non-	\$
CIAC/Advances)		(196,141,172)
	Refunds for	\$
Advances		(9,708,371)
		<hr/>
	Cash Available For	\$
Dividends		7,937,789
		<hr/>
		\$
	Less: Dividends Paid	(51,026,400)
		<hr/>
		\$
	Cash Over (Short)	(43,088,611)
		<hr/>
		\$
	Add: Other Net	35,179,336
	Sale of Property	\$
Rights		4,107,949
		<hr/>
		\$
	Cash Increase (Decrease)	(3,801,326)
		\$
	Beginning Cash 1-1-90	3,914,392
		<hr/>
		\$
	Ending Cash 12-31-04	<u>113,066</u>

(Exh. 63, p.39)

The Water Division determined that San Gabriel would have had a cash shortage of \$43,088,611 after paying \$51,026,400 in dividends during the years 1990 to 2004, if not for the fact that San Gabriel had received cash of \$39,287,285, comprised of \$35,179,336 in Other Net and \$4,107,949 in Sale of Property Rights. Other Net is used as an item of cash flow in the Statement of Cash Flow. The Water Division believes that this item along with Sale of Property Rights include \$27,811,312 in proceeds that San Gabriel received during 1996 to 2004 from contamination lawsuit settlements, service duplication, sale on condemnations, and sale to property owners. Id.

Of the \$51,026,400 dividends paid during 1990 to 2004, \$40,855,200 of the dividends was paid during 1996 to 2004. Clearly, San Gabriel would not have been able to pay \$40,855,200 in dividends without the \$27,811,311 cash inflow from proceeds that San Gabriel claims to have reinvested in Section 790 plant infrastructure, which included \$13,901,748 from the Fontana Division. The Water Division believes that dividend

payments totaling \$40,855,200 during 1996 to 2004 casts grave doubt on San Gabriel's claim that the \$27,811,312 of proceeds received during those years, \$13,901,748 from the Fontana Division, was reinvested in Section 790 plant infrastructure. (Ex. 63, p.40)

Unless San Gabriel can explain how \$40,855,200 in dividends can be paid to shareholders without using the \$13,901,748 of Fontana Division proceeds, the Water Division concludes these proceeds were used for paying shareholder dividends. By using those proceeds to pay dividends, the Water Division concludes that San Gabriel had no intention to reinvest the \$13,901,748 of Fontana Division proceeds in Section 790 plant infrastructure within the required eight-year period. As stated previously, Section 790 requires that the net proceeds and interest that is not invested after the eight-year period must be allocated solely to ratepayers. Id.

Therefore, the Water Division recommends that San Gabriel allocate to Fontana Division ratepayers \$13,901,748 in net proceeds, plus interest. Id.

B. Sources of Gain

1. Sales to Private Parties

During 1996 to 2004, San Gabriel received \$507,199 in proceeds for utility property sold to private property owners in its Fontana Division. The gain on sale was \$431,044. (Ex. 63, p.26)

These sales occur when San Gabriel receives requests from customers, who are private property owners, to abandon and sell no longer needed easements or facilities in order for the owner to complete planned improvements. Id.

2. Condemnation Proceeds

San Gabriel received \$2,520,148 from condemnation proceedings with government agencies during 1996 to 2004 in its Fontana Division. The gain on sale was \$2,421,727. (Ex. 63, p.24)

3. Proceeds of Service Duplication Judgment

During 1996 to 2004, San Gabriel received \$2,314,538 for the Fontana Division as damages for service duplication by other parties. (Ex. 63, p.22)

On October 30, 1996, San Gabriel entered into a settlement agreement with the City of Fontana where the City settled and paid San Gabriel \$2,314,538 for just compensation for the City's taking of San Gabriel's property and service area rights, with regard to water service for the Hunter's Ridge development, under inverse condemnation by service duplication under the Service Duplication Laws. Id.

4. Proceeds From Contamination Settlement

On November 10, 1998, San Gabriel entered into a settlement agreement (Mid-Valley settlement) with the County of San Bernardino (County) where the County agreed to pay San Gabriel compensation for the taking or damaging of San Gabriel's property by contamination from the County's Mid-Valley Sanitary Landfill. San Gabriel reported that it received, for the period 1998 to 2004, \$8,559,863 from the County. These proceeds are comprised of the following:

Compensation for damages from 3-1-97 to 12-31-99	\$ 4,052,449
Costs to construct Plant F-10 remediation facilities	3,996,455
Delay in restoring Plant F-10 to full service	455,959
Additional damages (addendum agreement)	<u>55,000</u>
Total	\$ 8,559,863

(Ex. 63, p.10)

In addition, the County promised to pay compensation to San Gabriel for the actual costs to operate and maintain the Plant F-10 facilities (Plant F-10) after they were completed. For the period May 2000 to December 2004, San Gabriel incurred \$1,242,057 in actual operating and maintenance costs, and the County reimbursed the costs entirely. These reimbursed expenses were recognized in the last Fontana general rate case. Although they were included in Test Year expense estimates, they were offset by the inclusion of estimates for the reimbursed revenue, and therefore revenue neutral for ratemaking purposes. (Ex. 63, p.11)

Of the \$8,559,863 proceeds received from the County, \$4,107,449 (\$4,052,449 plus \$55,000) represents compensation for damages resulting from water contamination from the County's Mid-Valley landfill. San Gabriel reported no plant assets had to be

retired from the water contamination. San Gabriel, however, did not consider these proceeds as CIAC, and thus, recorded these proceeds into a miscellaneous surplus account in its accounting records. Id.

San Gabriel documented through its job orders that it cost \$2,618,291 to construct the treatment facilities for Plant F-10. In the last Fontana GRC, DRA took issue and contended that it cost \$3,429,759 to construct the treatment facilities, and that this created a discrepancy in what San Gabriel reported for Plant F-10. Id.

The Water Division reviewed Plant F-10 construction work orders, payments to contractors, and conducted a physical inspection of Plant F-10. It determined that San Gabriel was correct in reporting costs totaling \$2,618,291 to construct the Plant F-10 treatment facilities. DRA's figure inadvertently included \$217,600 in duplication costs, and \$593,868 costs for booster pumps that San Gabriel constructed on Plant F-10, but were not part of the treatment facilities. Id.

In the last Fontana GRC, the decision classified the \$2,618,291 reimbursement to construct the Plant F-10 treatment facilities as CIAC for ratemaking purposes, decision classified the, and accordingly ratebase was reduced by the same amount. Although, San Gabriel intends to continue classifying the \$2,618,291 reimbursement as CIAC for ratemaking purposes in the current Fontana GRC, the Water Division found that San Gabriel has not adjusted its accounting records to record the reimbursement as CIAC, but the Water Division recommends that it do so. Id.

There is an excess of \$1,834,123 (\$3,996,455 plus \$455,959 received in settlement minus \$2,618,291 costs) in proceeds earmarked for Plant F-10 treatment facilities, which San Gabriel received, but did not use for building Plant F-10 treatment facilities. San Gabriel claims that any excess proceeds were reinvested in Section 790 plant infrastructure. (Ex. 63, p.11)

Excluding \$2,618,291 of costs to build Plant F-10 treatment facilities from \$8,559,863 proceeds that San Gabriel received in the Mid-Valley settlement, there is an excess of \$5,941,572 in proceeds that SGV received in the settlement. San Gabriel claims to have reinvested all excess proceeds in Section 790 plant infrastructure. Id.

C. Issue Areas

1. Application of Section 790

Public Utilities Code Section 790(a) states:

Whenever a water corporation sells any real property that was at any time, but is no longer, necessary or useful in the performance of the water corporation's duties to the public, the water corporation shall invest the net proceeds, if any, including interest at the rate that the commission prescribes for memorandum accounts, from the sale in water system infrastructure, plant, facilities, and properties that are necessary or useful in the performance of its duties to the public. For purposes of tracking the net proceeds and their investment, the water corporation shall maintain records necessary to document the investment of the net proceeds pursuant to this article...

Whenever a water company sells any real property that previously was necessary or useful in performing duties to the public, but is no longer, the water company must invest the net proceeds of such sales, including any interest, to water system infrastructure, plant, facilities, or properties that are necessary or useful to the public. Additionally, the water company must maintain adequate records in order to track actual net proceeds and investment for compliance under Section 790.

a) Sales to Private Parties

Regarding San Gabriel's sale to private property owners, the Water Division reviewed engineer reports and found the properties sold were no longer necessary or useful. Section 790 governs the \$507,199 SGV received during 1996 to 2004 for the sale of abandoned property to private owners. (Ex. 63, p.26)

b) Condemnation Proceeds

San Gabriel states the \$2,520,148 received were invested into plant infrastructure in accordance with Section 790.

San Gabriel supported its condemnation proceedings with engineer reports in showing the properties were no longer necessary or useful. However, when the Water Division reviewed the engineer reports, it found that many of the sold properties appeared

to still be necessary or useful up to the point of the condemnation proceeding. (Ex. 63, p.24)

The engineer concluded that the properties were no longer necessary or useful because of the impending pressures of imminent condemnation proceedings commencing. San Gabriel's view appears to be that properties are no longer necessary or useful when they are threatened by imminent condemnation. The Water Division believes it is unacceptable to classify a property as "no longer, necessary or useful" to satisfy Section 790 simply because it is being threatened by imminent condemnation. Threatened property may still be physically necessary or useful to a utility, and the utility always has the option of opposing the condemnation action. The Water Division concludes that condemnation proceeds do not qualify under Section 790. Id.

c) Proceeds of Service Duplication Judgment

San Gabriel claims that service duplication proceeds qualify under Section 790. The Water Division concludes that the \$2,314,538 does not qualify as Section 790 proceeds because they were not the result of the sale of real property. There was no real property sale between San Gabriel and the City of Fontana. The settlement agreement with the City did not provide for any transfer of title or interest of property or rights to the City. Instead, the settlement paid San Gabriel just compensation under inverse condemnation by service duplication under the Service Duplication Laws. (Ex. 63, p.23)

d) Proceeds from Contamination Settlement

Section 790 only applies to the sale of real property. While reviewing the various water contamination settlement agreements, the Water Division found no sale of real property between San Gabriel and the other parties to the agreements. Additionally, the settlement agreements did not provide for any transfer of title or interest of property or rights owned by San Gabriel to these parties. (Ex. 63, p.15)

The Water Division concludes that the \$8,559,863 of water contamination proceeds San Gabriel received do not qualify under Section 790 because the proceeds

were not the result of a sale of real property, but instead were compensation for damage caused by water contamination. Id.

2. Application of Section 851

Public Utilities Code Section 851 states:

No public utility other than a common carrier by railroad subject to Part I of the Interstate Commerce Act shall sell, lease, assign, mortgage, or otherwise dispose of or encumber the whole or any part of its railroad, street railroad, line, plant, system, or other property necessary or useful in the performance of its duties to the public, or any franchise or permit or any right thereunder, nor by any means whatsoever, directly or indirectly, merge or consolidate its railroad, street railroad, line, plant, system, or other property, or franchises or permits or any part thereof, with any other public utility, without first having secured from the commission an order authorizing it so to do. Every such sale, lease, assignment, mortgage, disposition, encumbrance, merger, or consolidation made other than in accordance with the order of the commission authorizing it is void...

Utilities must first gain Commission authorization before selling, leasing, assigning, mortgaging or disposing of any of its property that is either necessary or useful in the performance of its duties to the public. Without such authorization, such transactions are void.

a) Sales to Private Parties- N/A

b) Condemnation Proceeds

As stated previously, the Water Division believes it is unacceptable to classify a property as “no longer, necessary or useful” to satisfy Section 790 simply because it is being threatened by imminent condemnation. And in fact, the Water Division found that many of the sold properties appeared to still be necessary or useful up to the point of the condemnation proceeding. The very fact that San Gabriel received condemnation proceeds for this property reflects the reality that the property had value at the time of condemnation. Thus, since San Gabriel sold properties that were still necessary or useful,

San Gabriel should have complied with Section 851 prior to selling these properties. San Gabriel, however, did not seek Commission authorization. (Ex. 63, p.24-25)

c) Proceeds of Service Duplication Judgment- N/A

d) Proceeds from Contamination Settlement- N/A

3. Recordkeeping

a) Accounting

b) Sales to Private Parties

San Gabriel deposited the sales proceeds in a general checking account and San Gabriel claims the proceeds were later reinvested in Section 790 plant infrastructure. San Gabriel, however, did not track these proceeds in a memorandum account. Without a means of tracking the proceeds to the invested plant infrastructure by the use of a memorandum account, or by some other equivalent record keeping system, the Water Division concludes that San Gabriel has not met its burden of showing that it complied with Section 790 by reinvesting \$507,199 in sales to private property owners in plant infrastructure. (Ex. 63, p.26)

c) Condemnation Proceeds

San Gabriel treated its condemnation proceeds as it did its sale receipts by depositing them in a general checking account, and thus commingled them with other cash deposits not related to condemnations. The Water Division reviewed job cost sheets and work authorizations, journal entries, and general ledger postings in which San Gabriel claimed would support its investments into plant infrastructure during 1996-2004. (Ex. 63, p.25)

The job cost documents disclosed the amounts actually spent on these projects, but did not indicate the funding sources. In fact, some of the projects commenced at a time before San Gabriel even received the proceeds. San Gabriel paid for these projects from the general checking account, where funds came from a variety of sources. *Id.*

Without a means of tracking the proceeds to the invested plant infrastructure by the use of a memorandum account, or by some other equivalent record keeping system,

the Water Division concludes San Gabriel has not shown it has complied with Section 790 by reinvesting \$2,520,148 of condemnation proceeds in plant infrastructure. *Id.*

d) Proceeds of Service Duplication Judgment

Even if the Service Duplication proceeds were Section 790 proceeds, San Gabriel again deposited the \$2,314,538 into San Gabriel's general bank account and commingled these proceeds with all other funds received by San Gabriel. It claims that these proceeds were later reinvested in Section 790 plant infrastructure, but the Water Division found that San Gabriel had not established a memorandum account established to track proceeds received or funds spent. The Water Division could not track the spending of the proceeds because there was no proof the proceeds were set aside or otherwise segregated, so that they could be properly-tracked. (Ex. 63, p.22-23) When it enacted Section 790, the Legislature did not intend to allow water utilities to use sales or condemnation proceeds as a source of miscellaneous cash to use as the utilities deemed appropriate; rather the monies were meant to serve as an alternative source of capital for the utilities to build new water infrastructure. San Gabriel's cavalier attitude toward accounting for these proceeds is inconsistent with statutory intent.

Without a means of tracking the proceeds to the invested plant infrastructure by the use of a memorandum account, or by some other equivalent record keeping system, the Water Division concludes San Gabriel has not shown it has complied with Section 790 by reinvesting \$2,314,538 of service duplication proceeds in plant infrastructure. (Ex. 63, p.23)

e) Proceeds from Contamination Settlement

San Gabriel claims that the \$8,559,863 of water contamination proceeds are Section 790 proceeds, and claims to have reinvested those proceeds in Section 790 plant infrastructure within the required eight year period.² To support this, San Gabriel

² Section 790 (c) states "This article shall apply to the investment of the net proceeds referred to in subdivision (a) for a period of 8 years from the end of the calendar year in which the water corporation receives the net proceeds. The balance of any net proceeds and interest thereon that is not invested after the eight-year period shall be allocated solely to ratepayers."

provided a list of completed job orders as evidence of its reinvestment in plant infrastructure, and also pointed out that the costs incurred in these job orders were over the amount of the proceeds received by San Gabriel, and therefore San Gabriel complied with Section 790. (Ex. 63, p.14)

The Water Division reviewed these job orders, and noted that the dates of these orders ranged from 1996 to 2002, which corresponds to the time San Gabriel received the contamination proceeds. There were, however, no indications that any of the job orders were directly funded by the proceeds. And upon further review of the job order documentation provided by San Gabriel, the Water Division could not find any indication that any of the job orders were for contamination-related purposes. *Id.*

The job orders were primarily for general improvement purposes, such as in and around different streets and highways. They were also for installations of various types of equipment, such as fire hydrants, valves and piping. More importantly, the job orders related to construction of the Fontana Plant F-10 water treatment facilities were not even included in the list of job orders. *Id.*

San Gabriel deposited the water contamination proceeds into its general bank account and then commingled these proceeds with all other funds received by San Gabriel. San Gabriel did not set up a memorandum account to track the proceeds received against funds spent. The Water Division was not able to track the spending of the proceeds because San Gabriel could not provide appropriate documentation of how it accounted for the funds, segregated them or otherwise tracked the money. (Ex. 63, p.15)

Even if the contamination proceeds qualified under Section 790, without a means of tracking the proceeds to the invested infrastructure by the use of a memorandum account, or by some other equivalent record-keeping system, the Water Division concludes that San Gabriel has not met its burden of showing that it complied with Section 790 by reinvesting the \$8,559,863 water contamination proceeds in plant infrastructure. *Id.*

f) Tracking- N/A

4. Allocation of Proceeds

a) Calculation of Net Gain

The total amount of net gain from the above identified items is \$13,901,748. The \$13,901,748 consists of the following items previously discussed:

Gain on Sale to Private Owners\$507,199
Gains on Condemnation\$8,559,863
Gains on Service Duplication\$2,314,538
Gains on Condemnation\$2,520,148

In determining the amount of net gain, identified above, DRA did not reflect an income tax offset. It is Commission Policy to use flow-through accounting with the exception of Federal accelerated depreciation and the California Corporate Franchise Tax. Flow-through accounting is being recommended by, and presented by, DRA for purposes of determining the net gains to return to ratepayers without any tax offsets because there is no evidence in this proceeding that taxes have, in fact, been paid by San Gabriel on the proceeds. If the tax offset were to be reflected, absent evidence that taxes have, in fact, been paid, a deferred income tax credit would be required to be reflected as an offset to rate base in addition to the net of tax Contribution In Aid of Construction balance. It is the full \$13,901,748 that should be recorded as CIAC. As the CIAC is amortized, it will impact income tax expense in that manner. Thus, ratepayers will pay the income tax impacts as the CIAC is amortized.

San Gabriel has attempted in its Exhibits 86a and 87a to offset the proceeds received with certain legal expenditures. DRA disagrees with these offsets, which would result in a double-recovery by San Gabriel of the legal expenditures. This is addressed in greater detail under the Ratemaking Effects discussion, below.

b) Allocation of Net Gain

As indicated above, DRA recommends that 100% of the net proceeds, or the full \$13,901,748, be returned to ratepayers by recording the amount as Contributions in Aid of Construction, which is an offset to rate base.

Per ALJ Barnett's directive, DRA has also presented DRA Exhibit 87B, which reflects the allocation of the net gain requested by the ALJ, with 100% of the Gain on sale to private owners going to shareholders and a 75% ratepayers / 25% shareholder split of the remaining balances. However, DRA continues to recommend that 100% of the funds be ultimately flowed to ratepayers by offsetting CIAC for the full \$13,901,748. Awarding even 25% of the proceeds to San Gabriel's shareholders allows the Company to substantially benefit from its failure to properly account for these monies as required by the express provisions of Section 790.

D. Ratemaking Effects

1. Adjustment to Revenue Required for Test Year 2004

Under the DRA's recommendation that 100% of the net proceeds should be returned to ratepayers, the impact on the revenues that have been collected by San Gabriel from the time the rates from the prior case went into effect in July 2004 through June 30, 2006 of this year is \$4,313,200. This consists of \$1,023,300 collected in the second half of 2004, \$2,193,300 collected in 2005, and \$1,096,600 to be collected in 2006 through June 30th. This amount was calculated utilizing the same methodology as provided in DRA Exhibit 86B, with the difference attributable to 100% of the proceeds being attributable to ratepayers instead of the split recommended by ALJ Barnett. DRA recommends that the \$4,313,200 collected from ratepayers since the prior rate case associated with the proceeds be refunded to ratepayers.

As directed by ALJ Barnett, DRA has provided Exhibit 86B in this docket, which shows the impact on the revenue requirement that went into effect in 2004 based on ALJ Barnett's recommended split between ratepayers and shareholders. DRA's calculated recognition of the net gain based on ALJ Barnett's recommended split reduces San Gabriel's revenue requirement that has been collected from customers since the last case by \$670,900 for the last six months of 2004, \$1,438,400 in 2005 and \$719,200 for rates in effect in 2006 through June 30, 2006. These result in a cumulative amount collected from ratepayers based on rates set in the prior case of \$2,828,500. Based on the ALJ's recommended split between ratepayers and shareholders of the proceeds, DRA's calculation and San Gabriel's calculations are different only in the determination of what cost will ultimately be flowed back to ratepayers as CIAC.

In Exhibit 86B, DRA has not reduced the net gain presented by San Gabriel for legal costs already reflected in rates and for income taxes. Exhibit 86A submitted by San Gabriel reflects a reduction for \$1,050,499 for legal costs and a reduction of \$3,772,280 for income taxes at an effective tax rate of 40.746%. The reduction for legal costs is inappropriate because the costs are the same costs that are included in the Company's requested 10 year average of non-perchlorate related outside legal services expense requested in this proceeding. (Ex. 84) Additionally, in prior cases, legal expense would have been included in the determination of the appropriate base rates for San Gabriel. San Gabriel would have included legal fees in prior rate cases, since it would have been a prudent. (Tr. Vol 6, p. 520-521, Charvez/DRA)

In fact, in the prior Fontana Division rate case, Application 02-11-044, the Commission's Decision 04-07-034 dated July 8, 2004 specifically states, at page 22, that "San Gabriel analyzed its outside legal costs over a 10-year period to develop an average, normalized estimate applicable to Fontana Division." In that decision, at page 22, the Commission adopted San Gabriel's estimate, based on the ten year

average level. Those ten years included the years in which the legal costs San Gabriel is attempting to utilize as an offset to the proceeds were incurred. Thus, these costs have already been factored into base rates and have already been recovered via those base rates in the years incurred, coupled with the use of a ten-year average legal cost normalization methodology adopted in the decision in the prior rate case.

These legal costs were not deferred on the Company's books in prior years, were not included in a memorandum account for future recovery, and were effectively recovered from ratepayers in base rates in the years incurred. To allow San Gabriel to now offset the net gain with the legal costs reflected on San Gabriel's Exhibit 86A, page 3 of 3, would in effect allow San Gabriel to double recover the legal expenditures. Ratepayers should not be asked to reimburse San Gabriel twice for its litigation expenses.

DRA does not recommend that the net gain be reduced for income taxes. There is no evidence that taxes have been paid, and it is Commission policy to use flow-through accounting for income taxes except for the tax differences due to Federal accelerated depreciation and the California Corporate Franchise Tax. In San Gabriel's witness David Batt's prefiled testimony, he strongly suggests that any tax on the gain from the proceeds in question has been deferred under Section 1033 of the Internal Revenue Code. (See Exhibit 6, pp. 3-4) Absent direct evidence to the contrary, the Company's testimony indicates that taxes have not been paid on these amounts. As indicated, DRA recommends that the Commission policy to use flow-through accounting for income tax purposes be adopted and zero taxes be reflected as an offset to the gain to be reflected as CIAC.

2. Adjustment to Revenue Required for Test Year 2006-2007

After flowing the 100% return to ratepayers through the same calculation methodology presented in Exhibit 87B, the impact on rate base would be a reduction

of \$12,758,700. Depreciation and amortization expense would be reduced by \$290,000 reflecting a 2.57% CIAC amortization rate, and ad valorem taxes would be reduced by \$55,200. The differences in calculating this amount versus the calculations in Exhibit 87B is that 100% of the gains are returned to ratepayers instead of ALJ Barnett's recommended split.

The overall impact on revenue requirement, based on the settled upon rate of return of 9.33% and the DRA's recommended gross revenue conversion factor, including the agreement regarding the uncollectibles rate, is an incremental reduction to revenue requirement for Test Year 2006-2007 of \$2,079,500. This incremental reduction to revenue requirement should be added to the DRA current position reflected in Joint Exhibit 88, which did not include the impacts of the Water Division audit recommendations. The final resulting required operating revenues for Test Year 2006-2007 would be \$37,473,300 when the impact of the Water Division audit recommendation, flowing back 100% of the proceeds to ratepayers, is incorporated.

DRA has also provided Exhibit 87B, per ALJ Barnett's request, which shows the impact of ALJ Barnett's recommended split between ratepayers and shareholders of the proceeds on the Company's original position in this case, which would be a \$1,841,500 reduction to the Company's originally proposed revenue requirement. This reflects the originally requested rate of return of 10.80% and the as-filed revenue conversion factor impacts. To be consistent with San Gabriel's Exhibit 87A presentation, we did not include the impacts of the agreement between DRA and San Gabriel on rate of return in Exhibit 87B. While we utilized a similar methodology as San Gabriel in preparing Exhibit 87B, we did not reflect the impact of San Gabriel's proposed offsets for legal expense and income taxes, each of which were discussed previously.

3. Effect on rates

As indicated above, the impact of DRA's recommendation that 100% of the proceeds be reflected as Contributions in Aid of Construction results in a \$2,079,500 reduction to the Test Year 2006-2007 required operating revenues in this case. This is calculated based on the reductions to rate base, depreciation and amortization expense, and ad valorem taxes identified in the above section, along with the application of the settled upon rate of return on DRA's recommended revenue conversion factor.

Additionally, the impact on rates collected by San Gabriel for the period since the prior rate case, part of 2004, 2005 and 2006 through June 30, was \$4,313,200. DRA recommends that this amount collected since the prior rate case be refunded to ratepayers.

The above amounts for both the impact on base rates to be set in this case and for the amounts to be refunded do not include any carrying charges on the ratepayer provided funds for the period in which San Gabriel had use of the funds through the time base rates in this case go into effect. Thus, DRA recommends that the above identified amounts be increased further by the interest to be accumulated from the time the proceeds were received by San Gabriel until base rates from this case go into effect so that ratepayers receive compensation for the Company's use of those funds.

E. Los Angeles County Division

DRA respectfully requests that the issues regarding the Audit for the Los Angeles County Division be preserved for the next Los Angeles GRC since this current proceeding for San Gabriel's Fontana Division did not cover the issues for the Los Angeles County Division. Lastly, DRA recommends that the Commission open an OII to investigate San Gabriel's practices, specifically in regards to its Water Quality Litigation Memorandum Account to see if any funds should be subject to refund. (Is this phrased right??)

XIV. CUSTOMER SERVICE

San Gabriel provided a summary of its customer service complaints, which identified the following complaints received for years 2002, 2003 and 2004:

Customer Complaints

TYPE	2002	2003	2004
Taste and Odor	17	21	17
Turbidity	3	3	1
Pressure (High or Low)	28	107	94
Sand	4	3	5
Air-Milky-Cloudy	0	0	0
Bill Inquiries	120	126	205
Leaks, Mains	46	63	59
Leaks, Services	785	641	638
Leaks, Hydrants	45	39	45
Misc. Other Complaints	24	23	21

Water Quality

During DRA's review at the Company's offices, San Gabriel provided a copy of the customer complaint logs for water quality complaints. These pertained to complaints by customers regarding taste and odor, turbidity and pressure issues. The Company keeps a binder with the customer complaint forms for complaints pertaining to water quality issues. Based on a review of the completed forms, San Gabriel adequately resolved the water quality issues arising during the period reviewed. The majority of the forms identified the cause of the water quality complaint to be water pressure related due to regulatory settings at the customer's end, which either the Company corrected or provided instructions on how the problem could be corrected.

A few complaints were noted with regards to the water pressure in the Hunter's Ridge development. The resolution identified on the forms indicated that water pressure is an issue at the Hunter's Ridge area. Several of the items included in the projected additions to plant in service should help to resolve this issue.

Additionally, DRA reviewed the water monitoring and testing records for each plant during the on-site visit at the Company's offices. San Gabriel took plants with elevated levels of contaminants out of service. Based on the documents reviewed and DRA's discussions with Company personnel, the Company appears to be in compliance with its water quality standards.

Billing Inquiries

During DRA's on-site visit, DRA requested copies of the Customer bill inquiry forms. The Company had summaries regarding billing inquiries, but not the actual billing inquiry forms that were completed, other than for the month of September 2005. The actual billing inquiry logs are kept in the individual customer files in Fontana. There is one file for each connection and no listing is kept by customer or connection of the billing inquiries. In order to review the leak complaint logs, one has to go through the individual customer connection files to attempt to locate the inquiry forms. The forms for September 2005 were available for review as the forms for September 2005 had not yet been filed in the individual customer connection files.

There were 99 bill inquiry forms provided for September 2005. Of the 99 bill inquiry forms, ten of the inquiry forms indicated the customer was, in fact, overbilled and an adjustment was noted on the form.

The customer service complaint listing provided in San Gabriel's filing indicated that there were 126 bill inquiries in 2003 and 205 bill inquiries in 2004. As indicated above, the total number of bill inquiry forms reviewed on-site for the month of September 2005 were 99. Due to the Company's methodology for tracking its bill inquiries, the amounts presented in the Company's filing are understated.

The number of bill inquiries identified in the Company's filing consist only of the bill inquiries that are tracked in the Company's billing inquiry log. Only the billing inquiries where an employee went out to a customer's premises and actually met with a customer in person were reported in the log. Consequently, any billing inquiries that were resolved over the phone or resolved via an on-premise inspection without direct in-person contact with the customer were not included in the billing inquiry log and were not included in the billing inquiry amounts identified in San Gabriel's filing.

Beginning in June 2005, San Gabriel modified how it tracked billing inquiries. Beginning in June 2005, San Gabriel began separately tracking billing inquiries where: (1) an employee re-reads the meter and leaves a notice on customer premises; (2) an employee re-reads the meter or checks for leaks and the customer ends up being present, but there was not appointment; and (3) an employee reads the meter or checks for leaks and an appointment was made with the customer.

In order to determine the full number of customer bill inquiries, one would have to go through each and every customer connection file to see if a bill inquiry form is present in the file. The same task would have to be performed to confirm the number of leak inquiries identified in the filing.

DRA recommends that San Gabriel immediately begin keeping a copy of each and every bill inquiry form in a separate, centrally located file. This will allow for complete and accurate bill inquiry reporting, and would allow DRA to review future bill inquiry forms. According to the rebuttal testimony of San Gabriel witness Michael McGraw, San Gabriel agrees with DRA's recommendations and will set-up a separate centrally located file for Bill Inquiry forms beginning January 1, 2006. (Ex. 22, p.3) San Gabriel should also keep a copy of each and every leak report/inquiry in a separate, centrally located file. San Gabriel could still place copies in the individual customer connection files, but copies should also be centrally located for review.

XV. PENALTIES OR REWARDS

Pursuant to the Commission's Rules of Practice and Procedure, Rule 1 and 1.5 and Public Utilities Code Section 2107, DRA hereby requests monetary penalties be assessed against San Gabriel.

Under Appendix A of Decision 98-12-075 on Standards of Conduct Governing Relationships Between Energy Utilities and Their Affiliates, the Commission illustrated "the principles that the Commission has historically relied upon in assessing fines and restates them in a manner that will form the analytical foundation for future decisions in which fines are assessed." (1998) 190 P.U.R.4th 6,*70. Thus, even though this decision pertains primarily to energy utilities and their affiliates, it explains the principles the Commission utilizes in determining fines against utilities.

First, reparations must be distinguished from fines. Reparations are refunds of excessive or discriminatory amounts collected by a public utility. The purpose is to return funds to victims that were unlawfully collected by the public utility. Reparations must be paid to the victims. *See id.* Fines in contrast, are meant to "effectively deter further violations" by the particular utility or other utilities. Thus, fines are paid to the State of California, rather than to victims.

And effective deterrence creates an incentive for public utilities to avoid violations. *See id.* at *71. To achieve such deterrence, the Commission analyzes the 1) severity of the offense and 2) the conduct of the utility in setting fines. In reviewing the severity of the offense, the Commission analyzes the economic harm inflicted upon the victims and the "unlawful benefits gained by the public utility." The Commission then looks to the greater of these two amounts to establish the fine. *See id.*

In addition, many instances where the Commission has assessed fines, it has instituted them for reporting or compliance requirement violations. Thus, in such cases, the harm caused by the utilities is not to consumers, but to the "integrity of the regulatory

processes.” *See id.* at *72. According to Public Utilities Code Section 702, public utilities must comply with Commission directives:

Every public utility shall obey and comply with every order, decision, direction, or rule made or prescribed by the Commission in the matters specified in this part, or any other matter in any way relating to or affecting its business as a public utility, and shall do everything necessary or proper to secure compliance therewith by all of its officers, agents, and employees.

See id. “Such compliance is absolutely necessary to the proper functioning of the regulatory process.” *Id.* Thus, the Commission feels disregarding a statutory or Commission directive, regardless of the effects on the public, merits a high level of severity.

Here, because of its misapplication of Section 790 to its condemnation, service duplication, and contamination settlement proceeds, San Gabriel inflicted "economic harm" to its ratepayers by diverting \$13, 901,748 to its shareholders that should have been reinvested in Section 790 plant infrastructure, if in fact the proceeds were Section 790 proceeds. Instead, San Gabriel utilized this \$13,901,748 to help partially fund its pay out of \$40,855,200 in dividends. As stated previously, San Gabriel would not have been able to pay out the full \$40,855,200 worth of dividends to its shareholders absent the \$13,901,748 contribution.

San Gabriel caused harm to the "integrity of the regulatory process" via its improper accounting of its condemnation, service duplication and contamination settlement proceeds. It disregarded the literal language of Section 790 that states a water corporation must maintain records adequate enough to document the investment of proceeds. Instead, San Gabriel deposited the proceeds into its general bank account and then commingled these proceeds with all other funds it received. Since it did not set up a memorandum account to track the proceeds received against funds spent, the Water Division was unable to track the spending of the proceeds or even the receipt. San

Gabriel's actions in commingling the Audit proceeds and its other funds are clear examples of defiance of Section 790.

And again as stated above, compliance with Commission orders, decisions, and rules is vital to the "functioning of the regulatory process." Even assuming that San Gabriel's assertions that the proceeds fall under Section 790, the Company openly defied Commission Decision 03-09-021, which states Section 790 proceeds must be tracked by a memorandum account. If utilities can openly defy Commission directives with impunity, the regulatory process cannot function properly.

Another issue the Commission analyzes in assessing fines is the conduct of the utility. In its review, the Commission analyzes the public utility's conduct in: 1) preventing the violation; 2) detecting the violation; and 3) the utility's actions to disclose and rectify a violation. Lastly, the Commission also reviews: 1) the financial resources of the utility; 2) the totality of the circumstances in furtherance of the public interest; and 3) the role of precedent in assessing fines. *See id.* at *73-76.

In regards to preventing a violation, the Commission will look to whether the utility has utilized "prudent practice" by taking reasonable steps to ensure compliance with Commission directives. "This includes becoming familiar with applicable laws and regulations, and most critically, the utility regularly reviewing its own operations to ensure full compliance." *See id.* at *74.

Here, San Gabriel openly flouted a state statute and an explicit Commission decision, instead of utilizing "prudent practice" by taking reasonable steps to ensure compliance with Commission directives". San Gabriel's Witness Mr. Dell'Osa acknowledged the utilities non-compliance with D.03-09-021 when he testified that he did not understand Decision 03-09-021 and therefore did not follow it. (Tr. Vol.6, p.585-587, Dell'Osa/San Gabriel) Moreover, at no time did he nor others at San Gabriel ask for guidance from the Commission or staff even though San Gabriel was in constant contact with the Commission staff on other issues.

It is a utility's responsibility to become familiar with applicable laws and regulations, and Commission orders and to ensure its operations are in full compliance. Thus, San Gabriel has utterly failed in this responsibility.

Next, in considering a utility's actions to detect a violation, the Commission "expects utilities to monitor diligently their activities...Deliberate as opposed to inadvertent wrong-doing will be considered an aggravating factor." *Id.* The Commission will also look at the management's conduct during the time where the violation occurred to determine the level and extent of involvement in or tolerance of the offense by management personnel. *See id.*

Here, San Gabriel – by not setting up a memorandum account to track Section 790 proceeds and commingling the monies with other utility revenues-- failed to meet its responsibilities to the Commission and its customers by not diligently monitoring its activities to prevent a violation of a Commission decision or order. San Gabriel's defiance was not only flagrant, it was deliberate. Mr. Dell'Osa stated the Company saw no reason to use the "traditional method of a memorandum account" when asked if the Company made a conscious decision not to use the traditional method of a memorandum account. (Tr. Vol.6, p.571-572, Dell'Osa/San Gabriel)

Mr. Dell'Osa reiterated in his testimony that these actions or lack thereof in regards to memorandum accounts were management-wide opinions or decisions. (Tr. Vol.6, p.571-573, 585-588, 593-594, Dell'Osa/San Gabriel) These facts all serve as aggravating factors in determining a fine.

In reviewing a utility's actions to disclose and rectify the violation, the Commission will look to whether a public utility promptly informed the Commission of the violation and worked promptly to rectify it. *See id.* at *75. Here, with San Gabriel, as stated above, it most certainly did not work to disclose or rectify the violation of specifically D.03-09-021. In fact, it took the Water Division's efforts in the Audit to discover San Gabriel's active defiance of the decision and its self-serving interpretation of Section 790.

On the issue of a utility's financial resources, the Commission works to create fine levels to achieve the objective of deterrence without being excessive, but also based upon a utility's resources. Lastly, on the role of precedent, the Commission is expected to address previously issued decisions that involve comparable factual circumstances and to explain any substantial differences in outcome. *See id.* at *76. DRA acknowledges that the Commission must determine a fine that achieves deterrence against future violations by the particular utility and other utilities without being so excessive that the amount endangers the utility's ability to provide service to the public. The Commission should also review decisions with similar circumstances in determining a proper fine.

Besides San Gabriel's violation of Sections 790, 851, and D.03-09-021, San Gabriel has also misled or violated Commission rules. For example, as evidenced in the evidentiary hearings, it misrepresented its actual water supply, the Sandhill Project's actual costs, and the need for various plant projects, and engaged in an illegal affiliate transaction. All of these examples should lead the Commission to wonder if it can really trust what San Gabriel says about any issue. San Gabriel has a history of stating they are in dire need of particular plant projects or extra employees, but when these projects and people are approved, San Gabriel does not complete these requests. This continual syndrome of "crying wolf" should substantially diminish San Gabriel's credibility before the Commission. These types of deliberate and consistent misrepresentations are Rule 1 violations that serve to undermine the regulatory process.

DRA proposes setting a fine that will deter future violations not only of San Gabriel, but of other companies in the Water Industry. San Gabriel cannot be rewarded for actions that have thwarted and attempted to subvert the regulatory process. ALJ Barnett' proposed split of the proceeds of 75% to ratepayers and 25% to shareholders would encourage such bad behavior because San Gabriel would be allowed to retain one-quarter of its ill-gotten gains. Therefore, 100% of the Audit proceeds should be assigned to ratepayers as CIAC. DRA proposes a fine within the range of \$100,000-\$500,000. An amount in this range would provide effective deterrence to the industry and to San

Gabriel. Such an amount is warranted partially because San Gabriel has engaged in this type of skullduggery for essentially a decade.

Respectfully submitted,

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March 24, 2006

PROPOSED FINDINGS OF FACT

DRA will propose Findings of Fact in its Reply Brief.

PROPOSED CONCLUSIONS OF LAW

DRA will propose Conclusions of Law in its Reply Brief.

CERTIFICATE OF SERVICE

I hereby certify that I have this day served a copy of “**OPENING BRIEF OF THE DIVISION OF RATEPAYER ADVOCATES**” in “**A.02-11-044 and A.08-08-021**” by using the following service:

[**X**] **E-Mail Service:** sending the entire document as an attachment to all known parties of record who provided electronic mail addresses.

[] **U.S. Mail Service:** mailing by first-class mail with postage prepaid to all known parties of record who did not provide electronic mail addresses.

Executed on **March 24, 2006** at San Francisco, California.

Albert Hill

N O T I C E

Parties should notify the Process Office, Public Utilities Commission, 505 Van Ness Avenue, Room 2000, San Francisco, CA 94102, of any change of address and/or e-mail address to insure that they continue to receive documents. You must indicate the proceeding number on the service list on which your name appears.
